(1)

90-516

No. ________

In the

Supreme Court of the United States

October Term, 1990

JILL S. KAMEN,

Petitioner,

v.

KEMPER FINANCIAL SERVICES, INC., and
CASH EQUIVALENT FUND, INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

RICHARD M. MEYER
Suite 4915
One Pennsylvania Plaza
New York, New York 10119
(212) 594-5300

Attorney for Petitioner

Of Counsel:

MILBERG WEISS BERSHAD SPECTHRIE & LERACH
One Pennsylvania Plaza
New York, New York 10119

SHEFSKY & FROELICH, LTD.
444 North Michigan Avenue
Chicago, Illinois 60611

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

126

QUESTIONS PRESENTED FOR REVIEW

1. As a prerequisite to bringing a shareholder action on behalf of an investment company to recover damages for proxy fraud under Section 20 of the Investment Company Act, must the shareholder first make a demand upon the company's directors to bring the action even where such a demand would be futile?

2. Is there a right to jury trial in a shareholder action for money damages under the Investment Company Act?

TABLE OF CONTENTS

TABLE OF CONTENTS – Continued

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

OPINIONS BELOW

The February 2, 1987 opinion of the District Court for the Northern District of Illinois is reported at 659 F. Supp. 1153. The July 18, 1990 opinion of the Court of Appeals for the Seventh Circuit is reported at [Current Binder] Fed. Sec. L. Rep. (CCH) § 95,363.

JURISDICTION

The decision of the Court of Appeals for the Seventh Circuit was dated and filed on July 18, 1990. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Seventh Amendment to the United States Constitution provides:

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved . . .

Due to their length, Sections 20(a), 36(b) and 44 of the Investment Company Act of 1940, 15 U.S.C. Sections 80a-20(a), 80a-35(b) and 80a-43, and Rule 23.1 of the Federal Rules of Civil Procedure are set forth in the appendix at 96a-100a.

STATEMENT OF THE CASE

Petitioner is a shareholder of defendant Cash Equivalent Fund, Inc. (the "Fund"), an open-end investment

company or mutual fund registered under the Investment Company Act of 1940. She has brought the action on behalf of the Fund against its investment adviser (the "Adviser").[1]

The action is brought under Sections 20(a) and 36(b) of the Investment Company Act. Section 20(a) proscribes the fraudulent solicitation of proxies with respect to a registered investment company. The complaint herein alleges that the defendant distributed a false and misleading proxy statement which misrepresented comparative fees in order to obtain shareholder approval of its agreement with the Fund.

Section 36(b) provides that the investment adviser of a registered investment company owes it a fiduciary duty with respect to the compensation which the company pays the adviser. For breach of that fiduciary duty, the SEC, or a security holder on behalf of the investment company, may bring suit against the adviser. The complaint alleges that the compensation of the Adviser is excessive resulting in a breach of the Section 36(b) fiduciary duty.

Plaintiff made no pre-suit demand upon the directors to institute or prosecute the action. The complaint sets forth the reasons for not making such a demand. Those reasons are as follows:

> (a) With respect to the claims asserted under Section 36(b) of the Act, no such demand is required.

---

[1] *Kamen v. Kemper Financial Services, Inc.*, No. 85 C 4587 (N.D. Ill.). Jurisdiction of the District Court was invoked under Sections 36(b) and 44 of the Act, 15 U.S.C. Sections 80a-35(b) and 43 respectively.

> (b) The "interested" directors have a personal financial interest adverse to the successful prosecution of the lawsuit, and the so-called "non-interested" directors are beholden to the Adviser; they receive aggregate remuneration of approximately $300,000 a year as directors of the Fund and other funds managed by the Adviser.
>
> (c) All of the directors voted to distribute the false proxy statement so that any suit brought to establish liability for the falsity of the statement would establish their own culpability and liability.
>
> (d) The directors caused the Fund to oppose the action on substantive grounds.

In addition, the complaint alleges that the directors are under the control of the Adviser and that application of a demand requirement would be inconsistent with the federal policy underlying Section 20 of the Investment Company Act. In deposition testimony, the directors testified that they would not institute this action. In short, as alleged in the complaint, making a demand on the Fund or its directors to institute or prosecute this action would be futile.

With respect to both the Section 20(a) claim and the Section 36(b) claim, the complaint seeks damages only.

Defendants moved to dismiss plaintiff's claim of proxy fraud, and to strike plaintiff's demand for a jury trial. The District Court granted defendants' motion to dismiss the proxy fraud claim on the ground that plaintiff had failed to justify the absence of a demand upon the Fund directors to institute suit to recover for that claim. With respect to the Section 36(b) claim, the District Court struck plaintiff's jury demand on the ground that "the

action is essentially in equity and therefore not covered by the Seventh Amendment."

Plaintiff sought mandamus, with respect to the striking of the jury demand, in the Court of Appeals. The Court of Appeals denied the petition for mandamus without any opinion other than to cite *First National Bank of Waukesha v. Warren*, 796 F.2d 999 (7th Cir. 1986). In *Waukesha* the Seventh Circuit held that mandamus was not available to review the striking of a jury demand unless the denial of the jury right was irreparable upon appeal from a final judgment. This Court denied certiorari over Justice White's dissent. *Kamen v. Nordberg*, 485 U.S. 939 (1988).

Thereafter, the District Court, adopting the recommendation of a magistrate, dismissed the Section 36(b) claim on the ground that the plaintiff is an inadequate shareholder representative. Upon appeal the Court of Appeals reinstated the Section 36(b) claim, but affirmed the dismissal of the proxy fraud claim and the striking of the jury demand. With respect to the Section 20 dismissal, the Court of Appeals held that demand on directors must be made even if it be futile. With respect to the striking of the jury, the Court recognized that this Court's recent decision in *Teamsters Local No. 391 v. Terry*, 110 S. Ct. 1339 (1990), "appears to call into question the foundation" for prior opinions striking jury demands, but nevertheless adopted the holdings and rationale of one of those opinions (*In re Evangelist*, 760 F.2d 27 (1st Cir. 1985)).

REASONS FOR GRANTING THE WRIT

A. Demand Upon Directors

1. The Court of Appeals decision conflicts with applicable decisions of this Court.

The Court of Appeals based its holding with respect to demand on Rule 23.1 of the Federal Rules of Civil Procedure. The Rule provides, in pertinent part, that the complaint must allege the efforts made by the plaintiff to obtain the action she desires from the directors, "and the reasons for the plaintiff's failure to obtain the action or for not making the effort." As the Court below conceded, the rationale of the demand requirement "implies a futility exception," "[a]t least in principle." 14a. The concession is advisedly made. In modern times, the futility exception has rarely if ever been authoritatively questioned.[2] Yet the Court below decided that "The time has come to do away with it." 14a.

At least as early as *Hawes v. Oakland*, 104 U.S. 450 (1881), this Court held that a shareholder bringing a derivative action must make a demand upon the directors to institute and conduct litigation unless "it was not reasonable to require it." 104 U.S. at 461.

---

[2] "The demand requirement will be excused and the shareholder plaintiff will be permitted to proceed with litigation on behalf of the corporation in cases where the role of the directors in the challenged conduct (or the alleged domination and control of the directors by the alleged wrongdoers) is such that demand would be 'futile.' " Block, Radin and Rosenzweig, *The Business Judgment Rule in Shareholder Litigation*, 45 Bus. Law. 469, 473 (1990); and authorities cited therein.

The futility exception was again recognized in *Doctor v. Harrington*, 196 U.S. 579 (1905), which the Court of Appeals acknowledges as a plausible interpretation of that decision. However, said the Court below, *Doctor v. Harrington* is no longer good law because, in its view, *Doctor* was overruled in all but name by *Smith v. Sperling*, 354 U.S. 91 (1957). 18a. This statement is indeed strange. This Court in *Sperling* approvingly cited *Doctor v. Harrington* no less than three times. And, on the very issue involved here, this Court noted that the District Court had found:

> " . . .
>
> (4) that if demand had been made on Warner Bros. to institute suit, the management would not have been disqualified 'from faithfully doing their duty' as officers and directors but that 'such a demand would have been futile.'[2]

2. The bill therefore meets the requirements of Rule 23 (b) of the Rules of Civil Procedure, 28 U.S.C.A. that the stockholder show with particularity what efforts he made to get those who control the corporation to take action, 'and the reasons for his failure to obtain such action or the reasons for not making such effort.' And see Hawes v. City of Oakland, 104 U.S. 450, 26 L.Ed. 827; Delaware & Hudson Co. v. Albany & S. R. Co., 213 U.S. 435, 29 S. Ct. 540, 53 L.Ed. 862."

354 U.S. at 94 (footnote by the Court).

The Court below sought to sustain its position that *Sperling* effectively overruled *Doctor* by quoting language in the opinion bemoaning the delay attributable to the

demand issue. It is clear, however, that this Court was criticizing the expenditure of time by the lower courts in inquiring into what were essentially issues on the merits rather than accepting the complaint's allegations with respect to the preliminary issue of demand.

Delaware & Hudson Co. v. Albany & Susquehanna R.R., 213 U.S. 435 (1909), specifically recognized the futility exception. The Court of Appeals held that *Susquehanna* "is of no consequence" (19a) because it relied upon Rule 94 which has been amended many times in the course of its transformation to Rule 23.1. Assuming that the *Susquehanna* holding could be read more broadly, the Court of Appeals nevertheless felt it could be disregarded as "linked to its time." That is because the development of committees of independent directors washes away the assumptions upon which this Court has endorsed the futility exception to the demand requirement.

The difficulty with this approach of the Court of Appeals is that, contrary to its assumption that action by independent directors did not exist until the 1970's, committees of independent directors or disinterested officers representing the corporation have been formed to deal with interested director transactions since early in this century; *see, e.g.*, Note, *Legal Safeguards About Transactions Between a Director and the Corporation*, 83 U. Pa. L. Rev. 56, 59 (1934); Note, *Restrictions on Power of Directors To Contract*, 29 Colum. L. Rev. 338 (1929). Moreover, even were there validity to the Court of Appeals' assertion that the proliferation of committees of independent directors has washed away the rationale for prior Supreme Court decisions, that Court overstepped its bounds in overruling

the decisions of this Court. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 109 S. Ct. 1917, 1921 (1989):

> If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.

Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984), again illustrates the vitality of the futility exception. The Court below seeks to distinguish *Fox* on the ground that the futility there arose from the fact that the corporation was not empowered to bring the action; only the shareholder (or the Securities and Exchange Commission) could do so. But here, the Court does not question that, in fact, a demand would be futile; the directors will not initiate the lawsuit. Many of the arguments advanced in favor of requiring a useless act are the same arguments that were advanced in *Fox*. Thus the Court of Appeals suggests that a demand may lead to a renegotiating of the advisory contract, a changing of the level of services or even finding a new adviser. 10a. Acts short of litigation, says the Court, could have net benefits exceeding those of litigation. Similarly, in *Fox* the petitioner argued that, even if a demand be futile, it enables corporate management to pursue alternative remedies such as negotiating with the Adviser to obtain a return of fees and/or to terminate the advisory contract. Pet. Br. in *Fox*, pp. 17-18. This Court refused to accept the invitation to require plaintiff to perform a futile act.

Finally, it should be noted that the Court of Appeals declined to consider the impact of Maryland law, because

its applicability was not suggested until the filing of the reply brief.[3] Conversely, however, the defendants never

---

[3] In the present case, the Fund was a Maryland corporation when the action was commenced. The leading Maryland case is *Parish v. Maryland & Virginia Milk Producers Association*, 250 Md. 24, 242 A.2d 512 (1967), *cert. denied*, 404 U.S. 940 (1971). That case held that where the directors were involved in the wrongdoing, as they were here by sending out the false proxy statement, demand upon them to bring the action is properly excused. *Parish* also held that demand was excused because the directors affirmed their support of management's action after the commencement of the law suit. 242 A.2d at 546-47. To similar effect in applying Maryland law is *Rosengarten v. Buckley*, 565 F. Supp. 193, 197-98 (D. Md. 1982), which holds that under Maryland law, fraud, such as the proxy fraud involved here, vitiates the demand requirement. *See also Zimmerman v. Bell*, 585 F. Supp. 512 (D. Md. 1984), citing *Eisler v. Eastern States Corp.*, 182 Md. 329, 333 (1943), and *Oldfield v. Alston*, 77 F.R.D. 735 (N.D. Ga. 1978). In the last cited case, the Court, applying Maryland law, concluded, 77 F.R.D. at 740:

> "Accordingly, given plaintiff's allegations that all of the trustees either actively participated in the wrongful transactions or, at the least, approved or ratified such transactions with knowledge or notice of their illegality, the court concludes that demand upon the trustees to bring this action should be excused."
>
> . . . the conduct of the unaffiliated trustees in this action, which conclusively demonstrates their antagonism to it. ANRET's answer did not take a neutral position. Nor did ANRET merely oppose this action on the basis of lack of demand on the trustees or its shareholders. Rather, ANRET has vigorously opposed this action on the merits. In this regard, there is also authority that a demand upon directors or trustees is unnecessary where the derivative entity contests the action on the merits. *See, e.g.*,

(Continued on following page)

suggested, either in the District Court or in the Court of Appeals, that the futility exception be abolished. That was an undertaking solely by the Court of Appeals without warning to any of the parties.

The effect of the Court of Appeals decision in the instant case is to preclude shareholder enforcement of proxy violations under the Investment Company Act or the Securities Acts generally. But more broadly, as the Court below recognized (12a), requiring a futile "demand to the board puts the plaintiff out of court" in all but the most extraordinary cases. This Court has recognized the importance of shareholder actions in enforcing the securities laws and in policing corrupt management; *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964) ("Private enforcement of the proxy rules provides a necessary supplement

---

(Continued from previous page)

Meltzer v. Atlantic Research Corp., 330 F.2d 946, 948 (4th Cir.), *cert. denied sub nom., Scurlock v. Meltzer*, 379 U.S. 841, 85 S. Ct. 78, 13 L.Ed.2d 47 (1964).

Pursuant to *Burks v. Lasker*, 441 U.S. 471, 477-80 (1979), procedural questions such as demand are decided by reference to state law unless inconsistent with federal law in the sense that application of the state rule destroys the federal right. (The complaint herein alleges that application of a demand requirement would be inconsistent with the federal policy underlying Section 20 of the Investment Company Act; 93a.) The Court of Appeals opinion turns this guiding principle on its head by utilizing a concocted federal demand theory to prevent enforcement of a federal right, which enforcement would be countenanced by Maryland demand law.

to Commission action.");[4] *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 371 (1966) (" . . . derivative suits have played a rather important role in protecting shareholders of corporations from the designing schemes and wiles of insiders who are willing to betray their company's interests in order to enrich themselves."). The Court of Appeals decision is in conflict with these holdings.

2. **The Court of Appeals decision conflicts with decisions of other Courts of Appeals as well as prior decisions of its own.**

The vast majority of Circuits – indeed, every Circuit Court of Appeals which has ruled upon the issue – has held that demand is excused where it would be futile. Illustrative of the cases are the following: *Gaubert v. Federal Home Loan Bank Board*, 863 F.2d 59 (D.C. Cir. 1988); *Untermeyer v. Fidelity Daily Income Trust*, 580 F.2d 22 (1st Cir. 1978); *Galef v. Alexander*, 615 F.2d 51 (2d Cir. 1980); *Lewis v. Curtis*, 671 F.2d 779 (3d Cir.), *cert. denied*, 459 U.S. 880 (1982); *Meltzer v. Atlantic Research Corp.*, 330 F.2d 946 (4th Cir.), *cert. denied, sub nom., Scurlock v. Meltzer*, 379 U.S. 841 (1964); *Clark v. Lomas & Nettleton Financial Corp.*, 625 F.2d 49 (5th Cir. 1980), *cert. denied*, 450 U.S. 1029 (1981); *Allright Missouri, Inc. v. Billeter*, 829 F.2d 631 (8th Cir. 1987); *Greenspun v. Del E. Webb Corp.*, 634 F.2d 1204 (9th Cir. 1980). In addition, District Courts in the Sixth,

---

[4] The General Accounting Office recently found that the SEC lacks the resources to adequately regulate investment advisers, who currently manage about $4.6 trillion in assets. GAO, Investment Advisers (June 1990), GGD-90-83.

Tenth and Eleventh Circuits have similarly held: *Granada Investments, Inc. v. DWG Corp.*, 717 F. Supp. 533 (N.D. Ohio 1989); *Mullen v. Sweetwater Development Corp.*, 619 F. Supp. 809 (D.C. Colo. 1985); *First American Bank and Trust v. Frogel*, 726 F. Supp. 1292 (S.D. Fla. 1989). And prior decisions of the Court of Appeals for the Seventh Circuit also held that demand is excused where futile: *Thornton v. Evans*, 692 F.2d 1064 (7th Cir. 1982); *Nussbacher v. Continental Illinois National Bank*, 518 F.2d 873 (7th Cir. 1975), *cert. denied*, 424 U.S. 928 (1976). The decision below is a conscious and defiant break with the uniformity required – and, until now, adhered to – by this Court's carefully enunciated jurisprudence.

B. The Right To Trial By Jury

The Court of Appeals decision conflicts with applicable decisions of this Court

This Court has long recognized that the right to trial by jury is a basic and fundamental element of constitutional philosophy. *Simler v. Conner*, 372 U.S. 221, 222 (1963); *Bailey v. Central Vermont R. Co.*, 319 U.S. 350, 354 (1943). Because the Court below upheld the dismissal of the proxy fraud claim, it did not consider plaintiff's right to a jury trial thereunder.

Plaintiff's Section 20 claim for damages resulting from shareholder reliance on fraudulent misrepresentations in the Fund's proxy statement is an action to recover money damages. The materiality of fraudulent statements in proxy solicitations is a jury issue. *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 337, 355 (1979) (dissenting opinion). Plaintiff is clearly entitled to a jury trial on a

claim of proxy fraud; *Dasho v. Susquehanna Corp.*, 461 F.2d 11, 31 (7th Cir.), *cert. denied*, 408 U.S. 925 (1972).

Plaintiff is also entitled to a jury trial on her claim under Section 36(b). The Court below recognized that this Court's decision in *Teamsters Local No. 391 v. Terry*, 110 S. Ct. 1339 (1990) "appears to call in question the foundation" for earlier Courts of Appeals decisions[5] striking jury demands in actions brought under Section 36(b). Nevertheless, it accepted the guidance of those decisions rather than of this Court's teaching.

In *Terry* employees sued their Union for breach of the duty of fair representation, seeking as relief the back pay which they had lost. This Court held that the action was analogous to an equitable suit by a trust beneficiary against a trustee for breach of fiduciary duty. Nevertheless, said the Court, quoting *Ross v. Bernhard*, 396 U.S. 531, 538 (1970), "The Seventh Amendment question depends on the nature of the *issue* to be tried rather than the character of the overall action." (110 S. Ct. at 1347; emphasis added by the Court in *Terry*). Quoting from *Curtis v. Loether*, 415 U.S. 189, 196 (1974), the Court noted that "an action for money damages was 'the traditional

---

[5] The First Circuit in *In re Evangelist*, 760 F.2d 27 (1st Cir. 1985), and the Second Circuit in *Krinsk v. Fund Asset Management, Inc.*, 875 F.2d 404 (2d Cir.), *cert. denied*, 110 S. Ct. 281 (1989); and *Schuyt v. Rowe Price Prime Reserve Fund, Inc.*, 835 F.2d 45 (2d Cir. 1987), *cert. denied*, 485 U.S. 1034 (1988), held that the actions were characteristic of equitable suits because they sought relief in the nature of restitution. Earlier, the Second Circuit had held that the jury right depends upon the specific relief prayed for; *In re Gartenberg*, 636 F.2d 16, 18 (2d Cir. 1980), *cert. denied*, 451 U.S. 910 (1981).

form of relief offered in the courts of law.' " (110 S. Ct. at 1347). The Court upheld the right to a jury.

From *Terry* two questions appear to occupy primary importance: Whether the case presents legal issues and whether the relief prayed for is money damages. Justice Brennan, concurring, stated that the nature of the relief sought is paramount. Justice Stevens, concurring, emphasized the nature of the substantive right and whether the relief is typical of an action at law. The dissent urged that the action was analogous to a breach of trust suit and therefore equitable and that the relief sought had to be considered with other factors to determine whether it qualified the case as a common law action.

In the present case several factors combine to confer the right to trial by jury. In the first place the statute specifically authorizes an action for damages; no less than four times is the term used in Section 36(b). Section 36(b) authorizes a shareholder of an investment company to bring an action against an investment adviser or any affiliated person of an investment adviser to recover "damages" or to seek "other relief" with respect to payments made to an investment adviser or affiliated person.

Thus, under Section 36(b) a plaintiff shareholder may seek either damages on the one hand or, on the other hand, equitable relief, such as an accounting or injunctive relief requiring the reduction of fees *in futuro*. The availability of alternative types of relief is confirmed by Section 44 of the Act.

Section 44, upon which jurisdiction of this action is based, confers jurisdiction upon federal district courts over "all suits in equity and actions at law brought to enforce any liability or duty created by" the Act. The Section thus draws the traditional distinction between a suit in equity and an action at law. With specific reference to Section 36(b), Section 44 goes on to provide "[t]he [Securities and Exchange] Commission may intervene as a party in any *action or suit* to enforce any liability or duty created by, or to enjoin any non-compliance with, section 36(b) of this title at any stage of such *action or suit* prior to final judgment therein." (Emphasis and interpolation supplied). Congress thus recognized in Section 44 that a shareholder's claim under Section 36(b) could be either a legal action (if it sought damages to enforce a duty) or an equitable suit (if it sought equitable relief to enjoin noncompliance). In the present case damages are sought.

Moreover, in this action the common law issue of fraud is presented, not simply by the Section 20 allegations, but also by the fact that under Section 36(b)(2) stockholder ratification must be tempered by the misleading proxy statement.

The Court below sought to distinguish *Terry* because it was the Union rather than the employer which was being sued for back pay. This made the case look more like one for damages than restitution. But the present case is not one for restitution either. Excessive advisory fees are not determined solely by what the Fund pays. Rather, the Court must look at all the facts in connection with the determination and receipt of advisory compensation, including so-called "fall-out" financial benefits received by the adviser; *Gartenberg v. Merrill Lynch Asset*

Management Co., 694 F.2d 923, 930, 932 (2d Cir. 1982), *cert. denied*, 461 U.S. 906 (1983).[6]

Moreover, here, as in *Terry*, the complaint seeks recovery from the Adviser of amounts retained by others. Paragraph 8 of the complaint (88a) attacks amounts paid to affiliates of the Adviser. Under Section 36(b), the Adviser can be held liable for amounts received by affiliates. In short, this action fits well within the constitutional mold of an action at law for damages entitling the parties to a jury trial.

This Court in *Terry* repeated one of the cardinal principles of American constitutional law:

> Maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care.

110 S. Ct. at 1344-45.

[6] The limitation in the statute of the amount of damages recoverable does not analogize the case to restitution but rather demonstrates the difference. Without such limitation, the Fund shareholders might well be entitled to a greater recovery as defined by the damages authorized by the statute.

CONCLUSION

The petition for a writ of certiorari should be granted.

Dated: New York, New York
September 20, 1990

Respectfully submitted,

RICHARD M. MEYER
Suite 4915
One Pennsylvania Plaza
New York, New York 10119
(212) 594-5300

Attorney for Petitioner

Of Counsel:

Milberg Weiss Bershad Specthrie & Lerach
One Pennsylvania Plaza
New York, New York 10119

Shefsky & Froelich, Ltd.
444 North Michigan Avenue
Chicago, Illinois 60611

APPENDIX

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 89-2967

JILL S. KAMEN,

Plaintiff-Appellant,

v.

KEMPER FINANCIAL SERVICES, INC., and CASH EQUIVALENT FUND,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 85 C 4587 – **Marvin E. Aspen,** *Judge.*

ARGUED MAY 11, 1990 – DECIDED JULY 18, 1990

BEFORE CUMMINGS, EASTERBROOK, and RIPPLE, *Circuit Judges.*

EASTERBROOK, *Circuit Judge.* Cash Equivalent Fund is a money market mutual fund with a sweeps feature. Brokers offer the Fund to their customers as an adjunct to their principal accounts. When an account has a cash balance, a computer "sweeps" the money into the Fund, where it earns interest until the customer reinvests in stocks or other financial instruments; the Fund redeems shares automatically to supply the cash for these transactions. The Fund and its investment adviser, Kemper

Financial Services, Inc., say that the extra costs of implementing a sweeps feature and the additional transactions it generates, plus the check-writing and wire transfer features of the Fund, justify a fee exceeding the norm for money market funds. Kemper receives an annual administration fee of 0.38% of the Fund's assets. It also receives an investment management fee starting at 0.22% of the first $500 million of the Fund's assets and dropping in increments to 0.15% of the assets exceeding $3 billion. As a result of these fees, the Fund pays interest at a rate approximately 0.2% per annum lower than money market funds that operate passively, including one that Kemper itself manages, the Kemper Money Market Fund.

Despite the difference in fees and payouts, the Fund has grown steadily and now manages more than $5 billion of assets. One might think this judgment of investors dispositive: offered extra services at lower interest, the Fund's investors chose the extra services; others have sent their money elsewhere to get a higher return. Whether the extra services are "worth" the price is the sort of judgment people make every day when deciding whether to buy a stripped down computer or pay extra for one with bells and whistles; our government does not try to determine whether extra features are worth a higher price.

Things are not so simple when the services are rendered by an investment adviser rather than a manufacturer or retailer of computers. Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. §80a-35(b), provides that the adviser of a registered investment company "shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services".

Fiduciary duties require honest dealing. Managers of all corporations owe fiduciary duties to their firms. These duties have never been thought to justify judicial review of levels of compensation paid, short of extreme cases amounting to waste. Nonetheless, §36(b) has been understood in light of its legislative history to put investment advisers on leases shorter than those of corporate managers generally, and to require the federal courts to decide whether the fees charged by investment advisers are "excessive". *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 534-41 (1984).

Jill S. Kamen, who owns shares of the Fund, filed this suit under §36(b), contending that Kemper's fees are excessive and should be reduced, with excess fees for prior years returned to the Fund. Kamen added a claim that in soliciting the investors' approval of the fee structure in 1984, the Fund had misleadingly compared the fees it pays to Kemper with the fees the Kemper Money Market Fund pays. Cash Equivalent Fund pays approximately 0.2% of its assets per annum more than the Money Market Fund does; Kamen believes that the proxy statement implied that the Fund's fees are equivalent to or lower than those paid to the Money Market Fund. Section 20(a), 15 U.S.C. §80a-20(a), forbids using the mails to send a proxy statement that violates rules established by the Securities and Exchange Commission. The SEC has by rule under the Investment Company Act adopted its rules under the Securities Exchange Act of 1934, which forbid materially misleading statements. See 17 C.F.R. §§270.20a-1(a), 240.14a-9(a).

Judge Nordberg first held that §20(a) creates a private right of action, 659 F. Supp. 1153 (N.D. Ill. 1987), and

then dismissed the portion of the complaint based on the proxy solicitation in 1984, holding that Kamen needed but had neglected to make a demand on the Fund's board of directors. See Fed. R. Civ. P. 23.1. He also struck Kamen's demand for a jury trial on the demand for restitution of excessive fees. We denied Kamen's petition for mandamus in an unpublished order because any error could be reviewed on appeal from a final decision, and the Supreme Court denied certiorari over Justice White's dissent, which observed that other courts of appeals disagree with *First National Bank of Waukesha v. Warren*, 796 F.2d 999 (7th Cir. 1986), on which the decision rested. *Kamen v. Nordberg*, 485 U.S. 939 (1988).

Although *Fox* holds that an investor need not made [sic] a demand on the directors when proceeding under §36(b), that claim did not last much longer. Judge Nordberg asked a magistrate to analyze Kemper's argument that Kamen is not an adequate representative of the other investors in the Fund. The magistrate recommended that the court grant summary judgment for the defendants on the §36(b) claim because Kamen is not an adequate representative of the class under Fed. R. Civ. P. 23. Magistrate Balog wrote:

> [N]o other shareholder has joined in this suit, instituted a claim, or inquired into plaintiff's action; the other shareholders have approved the fees charged by Kemper; after notice of plaintiff's allegations, the shareholders approved an increase in fees. Based on these facts, it can only be said that plaintiff's interests are antagonistic to those of the other shareholders. In such a case, plaintiff cannot adequately protect those interests. . . . It is apparent from the record as it stands that plaintiff's concerns are not those of a class, but are a private matter. As such, plaintiff cannot maintain this suit as a class action.

Judge Aspen, to whom the case was transferred for decision, adopted the magistrate's report and granted the "motion for summary judgment on the issue of plaintiff's adequacy as a class representative. This cause may proceed, if plaintiff so chooses, as a non-class action." After the parties pointed out that the suit was not filed as a class action, and that adequacy of representation is material (if at all) only under Rule 23.1, which governs derivative actions, the court entered judgment for the defendants, stating that because "plaintiff was adjudicated as a non-adequate representative plaintiff cannot proceed individually".

Kamen's appeal presents three questions: whether the §20 claim should have been dismissed for failure to make a demand on the directors; whether the §36(b) claim should have been dismissed because she stands alone among the Fund's shareholders; and whether, if the §36(b) claim should be reinstated, she would be entitled to a jury trial. Defendants maintain that only questions about the adequacy of representation are properly before us, because only that question was resolved in the final decision, and the notice of appeal identified only that decision as the subject of appeal. Defendants misunderstand the rules governing issues that may be litigated on appeal. An appeal from the final judgment brings up for review all decisions that shaped the contours of that judgment. E.g., *Chaka v. Lane*, 894 F.2d 923 (7th Cir. 1990); *Kaszuk v. Bakery & Confectionery Union*, 791 F.2d 548 (7th

Cir. 1986). It is unnecessary to identify earlier interlocutory orders in the notice of appeal. These orders may not themselves be appealed; they are not "final" and so are outside the scope of 28 U.S.C. §1291. Kamen's notice of appeal specified the final decision, and we have jurisdiction to review all of the legal questions preserved in the district court and in this court affecting the validity of that decision.

I

Kamen's complaint as finally amended alleges that she did not make a demand on the board of directors because the seven independent directors (of the ten-member board) "receive aggregate remuneration of approximately $300,000 a year for serving as directors of the Fund and all of the other funds in the Kemper group" and therefore "are dependent upon and subservient to" Kemper. It alleges in addition that demand would be futile because the Fund solicited the proxies, so a demand would request that the directors sue themselves, and that because the Fund has asked for the dismissal of the suit on the merits the directors obviously are not interested in pursuing the claims. Judge Nordberg thought these allegations insufficient to excuse a demand under Rule 23.1, as do we.

It is far from clear that Rule 23.1 applies to a suit under §20 of the Investment Advisers Act. The Rule applies to a "derivative action brought . . . to enforce a right of a corporation . . . , the corporation . . . having failed to enforce a right which may properly be asserted

by it". Violations of §20 do not yield rights "of the corporation" in the customary sense. Kamen does not sue in the right of the Fund; she sues the Fund for injury done her by the Fund. The theory of a suit under the proxy rules is that the corporation violated a right of the investor to truthful information. If the investor recovers against the corporation, it may in turn seek to recover from its directors, but the principal wrong is by the corporation against the investors. Kamen conceded in the district court, and again at oral argument in this court, that Rule 23.1 applies to her claim under §20. Perhaps she did this because she seeks as relief a payment to the Fund, and not a remedy for the investors personally. Whatever the reason for the concession, the question is not presented and we express no opinion on it. Similarly, we express no view on the question whether §20 creates a private right of action, and if so what the appropriate remedy may be. The district court held that the statute creates a right of action, 659 F. Supp. at 1156-60; our conclusion concerning the demand requirement makes it unnecessary to decide whether to imply such a right. See *Burks v. Lasker*, 441 U.S. 471, 475-76 & n.5 (1979).

The district court asked whether Kamen had satisfied the demand requirement of Rule 23.1, and the briefs on appeal debate the issue in these terms. Yet as we held in *Starrels v. First National Bank of Chicago*, 870 F.2d 1168, 1170 (7th Cir. 1989), Rule 23.1 governs pleading but does not create a demand requirement. Rule 23.1 requires the complaint to say with particularity what has been done about demand and why. Plaintiff may comply by saying that she made a demand or that a rule of law excuses demand.

What is the source of the rules requiring or excusing demand? When the claim for relief is based on state law, we held in *Starrels*, the law of the state in which the defendant is incorporated governs. See also *Burks*, 441 U.S. at 477-78. When the claim for relief is based on federal substantive law, then federal law also governs the requirement of demand. See *Burks*, 441 U.S. at 475-77. But cf. *Fox*, 464 U.S. at 542-47 (Stevens, J., concurring) (arguing that in cases under federal law there is no demand requirement unless the statute creates one). Federal common law contains a demand rule. *Hawes v. Oakland*, 104 U.S. 450 (1881).

Even when federal common law supplies the rule of decision, it may obtain that rule not from first principles but from state law. *United States v. Kimbell Foods Corp.*, 440 U.S. 715 (1979). This is especially appropriate under Rule 23.1, because the demand requirement is an aspect of the division of authority between corporate managers and investors, a division usually governed by state law. *Burks* holds that federal law with respect to directors' power to dismiss derivative suits should be derived from state law, unless the state law is hostile to federal interests. Perhaps the demand requirement, too, should be absorbed from state law. Few courts have considered this possibility. Cases both before and after *Burks* hold or assume that the demand requirement is a creature of federal law. See, in addition to *Hawes* and the cases cited in *Starrels*, 870 F.2d at 1170 n.4, our own opinions in *Nussbacher v. Continental Illinois National Bank*, 518 F.2d 873 (7th Cir. 1975), and *Thornton v. Evans*, 692 F.2d 1064, 1079-81 (7th Cir. 1982). Not until Kamen filed her reply brief in this court had anyone doubted that federal law defines the demand

requirement in this case. Kamen's reply brief suggested that we import the rules from Maryland law. (The Fund is a Maryland corporation.) The suggestion comes too late, *Wilson v. O'Leary*, 895 F.2d 378, 384 (7th Cir. 1990); we shall follow the tradition of *Hawes* and use federal common law.

The scope of the demand requirement depends on why demand *ever* is required. The demand rule could reflect a hope that the dispute will go away without litigation, that the board of directors will "do something" (or persuade the putative plaintiff that suit is pointless). Demand then initiates a form of alternative dispute resolution, much like mediation. Steps to control the volume of litigation are welcome, yet the demand rule creates more litigation than it prevents. It is difficult to identify cases in which the board's response to a demand satisfied the shareholder and thus prevented litigation; even if the board acts the shareholder may believe the board did too little. It is easy to point to hundreds of cases, including this one, in which the demand requirement was itself the centerpiece of the litigation. An approach uncertain in scope and discretionary in operation – that is, any rule except one invariably requiring or excusing demand – promotes litigation. When the stakes are high (as they frequently are in cases of this character), even a small disagreement between the parties about the application of a legal rule makes it difficult to resolve disagreements amicably.

A stronger rationale for the demand requirement is the one *Hawes* gives – that it allows directors to make a business decision about a business question: whether to

invest the time and resources of the corporation in litigation. 104 U.S. at 457, 461-62. See also *Fox,* 464 U.S. at 532-33; Deborah A. DeMott, *Demand in Derivative Actions: Problems of Interpretation and Function,* 19 U.C. Davis L. Rev. 461, 484-88 (1986); Daniel R. Fischel, *The Demand and Standing Requirements in Stockholder Derivative Actions,* 44 U. Chi. L. Rev. 168, 171-72 (1976). Firms must make operational decisions; if these misfire, they must decide what to do next. Each decision must be made with the interests of the corporation at heart. Whether to buy a particular combination of services at a particular price is a business decision. So too the decision to file a lawsuit about the price or pursue a different course, such as renegotiating the contract, changing the level of services, even finding a new adviser. Even doing nothing is justified when the resources of top managers required to act exceed the injury to the firm; when "something must be done", acts short of litigation could have net benefits exceeding those of litigation. If the directors run the show, then they must control litigation (versus other remedies) to the same extent as they make the initial business decision.

Choosing between litigation and some other response may be difficult, depending on information unavailable to courts and a sense of the situation in which business executives are trained. Managers who make such judgment calls poorly ultimately give way to superior executives; no such mechanism "selects out" judges who try to make business decisions. In the long run firms are better off when business decisions are made by business specialists, even granting the inevitable errors. If principles such as the "business judgment rule" preserve room for managers to err in making an operational decision, so too they preserve room to err in deciding what remedies to pursue. *United Copper Securities Co. v. Amalgamated Copper Co.,* 244 U.S. 261, 263-64 (1917).

Consider now why plaintiffs may resist making demand. (a) Delay in starting the litigation while the board ponders may injure the firm, perhaps because the statute of limitations is about to expire, perhaps because a questionable transaction is about to occur and it will be hard to unscramble the eggs if it happens before the court can act. (b) Demand may be futile, in the sense that the members of the board are interested in the transaction and unwilling to sue themselves, or because they are so set against litigation that their minds are closed. (c) Demand may be pointless, in the sense that a substantive rule prevents the corporation from controlling the litigation. *Fox* held that only an investor or the SEC may initiate litigation under §36(b), and it followed from the firm's inability to file its own case or prevent the investor from litigating that demand was unnecessary. Other statutes likewise may eliminate the point of making demand. (d) Demand may sometimes be imprudent from the plaintiff's perspective. Counsel who fear that the board *will* sue may hesitate before making a demand, because if the firm sues counsel will not reap the legal fees of victory. Or counsel may think that the board will pursue a strategy in litigation that his client disapproves, or settle for too little.

We will return to these four. Perhaps the most serious difficulty with demand from the perspective of plaintiffs is the link between the making of demand and the standard courts apply to the directors' decision not to sue. In

Delaware, the Mother Court of corporate law, any shareholder who makes a demand is deemed to concede that demand was required. *Spiegel v. Buntrock*, 571 A.2d 767, 775 (Del. 1990); *Stotland v. GAF Corp.*, 469 A.2d 421 (Del. 1983). If demand is required, then the disinterested members of the board are deemed to possess the ability to refuse to sue or control the litigation, provided their decisions are sufficiently reasoned to come within the capacious bounds of the business judgment doctrine. *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981); see also, e.g., *Aronson v. Lewis*, 473 A.2d 805, 813 (Del. 1984). Except in extraordinary cases, then, tendering a demand to the board puts the plaintiff out of court under Delaware law. No wonder plaintiffs stoutly resist making demands.

Federal courts have never embraced Delaware's link between the making of a demand and special deference to the board's decision not to sue. See *Bach v. National Western Life Insurance Co.*, 810 F.2d 509, 513 (5th Cir. 1987); *Joy v. North*, 692 F.2d 880, 888 n.7 (2d Cir. 1982) (Winter, J.). See also *Alford v. Shaw*, 358 S.E.2d 323, 327 (N.C. 1987) (rejecting a tie between demand and the standard of review). We think it would be unwise to do so. When the standard of review depends on the existence of a demand, plaintiffs have extraordinarily strong reasons not to make a demand, and corporations extraordinarily strong reasons to insist on one. Demand then becomes a threshold issue in every derivative suit, one that must be resolved in advance of discovery and on the basis of a good deal of speculation about what the board might do. As in *Spiegel*, the plaintiff will assert that the board is unreasonable. Why ask persons with closed minds? The

board will proclaim that Solomonic wisdom would be applied if only plaintiff would ask, while simultaneously asserting that the suit has no conceivable merit. It is not a pretty picture, but it is an extended and expensive one, made more so by some peculiarities in the way Delaware phrases its standards. See *Starrels*, 870 F.2d at 1174-76 (concurring opinion). As the American Law Institute has observed, "the need for demand and the standard of judicial review are logically very distinct." *Principles of Corporate Governance: Analysis and Recommendations* §7.03 comment *a* at 65 (Tent. Draft No. 8, 1988). We conclude that when the demand requirement comes from federal common law, the making of a demand does not affect the standard with which the court will assess the board's decision not to sue.

Four reasons remain why demand may be inappropriate: (a) exigencies of time; (b) futility; (c) irrelevance given a substantive rule; (d) the risk that demand will lead to suit and so deprive counsel of fees that might have been obtained were it necessary to file a derivative suit. We may at once discard (d) as a legal excuse. Cases in category (c) obviously never require demand. Cases in category (a) justify filing the complaint before receiving the board's answer to the demand but do not justify failure to make a demand. When time is tight, the investor should make demand at the same time he files the complaint. See *Delaware & Hudson Co. v. Albany & Susquehanna R.R.*, 213 U.S. 435, 447 (1909). Category (b), futility, is the usual sticking point. The plaintiff asserts that the board is interested or intransigent; the board asserts that it is reasonable and wise. Courts predictably

have great difficulty deciding who is right when, as is usual, it must decide such questions on the pleadings.

At least in principle the rationale of the demand requirement implies a futility exception. If courts would not respect the directors' decision not to file suit, then demand would be an empty formality. When all directors have a financial stake in the transaction, their decision not to sue themselves would carry little weight with a court. Or perhaps all of the directors are so ensnarled in the transaction that even when only the duty of care is at stake, their judgment could not be respected. Again demand seems an empty gesture. Courts dispense with futile gestures.

"In principle" is an important qualifier. In practice the futility exception to the demand rule has produced gobs of litigation. It is this exception that has sapped the potential role of the demand requirement as an alternative dispute resolution mechanism. Hundreds of cases opine on whether demand is or is not futile. Difficulties in sorting cases into demand-required and demand-excused bins are not worth incurring, once we sever the link between demand and the standard of review (as we have done). The American Law Institute recommends that courts abolish the "futility" exception to the demand rule, turning demand into an exhaustion requirement with much the same scope and function as the exhaustion requirement in the law of collateral review of criminal convictions. *Principles of Corporate Governance* §§7.03, 7.08, and commentary at 64-71 (Tent. Draft No. 8, 1988). "The futility exception . . . [is] ambiguous in scope and has proven a prodigious generator of litigation." *Id.* at 64. The time has come to do away with it. If demand is useful,

then let the investor make one; if indeed futile, the board's response will establish that soon enough. In either case, the litigation may proceed free of arguments about whether a demand should have been made in the first place. The virtue of simplification may be seen by considering three of the common battles about the meaning of "futility".

1. The plaintiff may say that some or all of the members of the board approved or are interested in the transaction and that demand is futile because they will not sue themselves or contest their own acts. Although directors are unlikely to sue themselves, they may well take some action to palliate the consequences of poorly conceived acts, including their own. Directors want the venture to succeed, and if shown how they can improve its prospects, are likely to act. One mistake at the time of the initial decision does not imply that the member of the board opposes remedial action. Even when the "action" involves suit against some of their number, this does not disable the board. The ALI properly observes, *id.* at 70-71, that the board may appoint a minority of disinterested members to evaluate the demand and act for the corporation. In the extreme case in which all members are implicated, the board may expand its size and authorize the new members to act for the firm. Of course it may choose to do none of these things, but if so it will just decline the demand. Making a demand is cheap, *especially* so when the board is disabled from acting. Why prefer extended, costly litigation to the cheap and quick expedient of a demand?

2. The board may be determined not to sue. Perhaps by the time the judge comes to consider whether plaintiff

should have made a demand, the defendant will have moved to dismiss the case on the merits. Any demand in such a case would be doomed to failure, and even at an earlier stage it may be transparent that the directors want nothing to do with litigation. This application of the "futility" exception has both a practical and a conceptual difficulty. The practical one is that it is difficult to tell in advance just what position the firm would take if asked; disputes about the demand requirement usually are resolved before the defendants plead to the merits. It is easy for the plaintiffs to *say* (and for the defendants to deny) that the board has a closed mind; it is much harder to tell who is right.

The conceptual difficulty is that even an adamant unwillingness to sue may reflect the merits. Boards ought not pursue silly or frivolous claims. So certain knowledge that the board is unwilling to authorize litigation may reflect only confidence that the case is feeble or injurious to the firm and other investors. Why should the plaintiffs be authorized to sue, and without so much as a request to the board, just because the complaint is all heat and no light? Once more the ALI hit the nail on the head when observing that a formulation of the futility rule that inquires whether a demand would prompt the board to correct a wrong "assumes that there is a wrong to be corrected. The director's antagonism to an action may well be justified and flow from a sound judgment that the action is either not meritorious or would otherwise subject the corporation to serious injury." *Id.* at 69. A decision not to file a weak lawsuit would be protected by the business judgment rule, so it makes perfect sense to ask for the board's perspective.

3. A plaintiff may insist that even the independent directors are toadies, so that their judgment could not be respected. Perhaps they are friends of the putative defendants; perhaps they draw hefty directors' fees and fear loss of their offices if they authorize suit; perhaps they believe that the courts have no business supervising corporate affairs and would not authorize litigation no matter how meritorious (and no matter how little their regard for holding onto their offices). If demand is futile in fact for any of these reasons, then the board will say no with dispatch and the case may proceed. As we have broken the link between the demand and the standard of review, the plaintiff may employ this arsenal of arguments to argue that the decision not to sue ought not be respected; the board will stand on the business judgment rule. The court will resolve the question on the merits rather than trying to treat it as a procedural hurdle. Framing questions about the independence of the directors as exceptions to the demand requirement diverts attention from the real issues.

Kamen's complaint pursues all three of these arguments for futility and has all the weaknesses we have identified. Courts frequently say that considerations of this sort do not demonstrate futility. The district court's able opinion collects many of the holdings, 659 F. Supp. at 1161-63. We are in accord, as *Starrels* demonstrates. Yet other cases, such as our opinions in *Nussbacher* and *Thornton*, accept the board's actual or anticipated unwillingness to sue as futility adequate to excuse demand, greatly complicating the resolution of litigation. The line between "potential futility" and "real futility" is increasingly refined.

Recent cases in several circuits display impatience with the futility exception and have been creative in denying that a demand would be futile even when it is pellucid that the board is not about to authorize a suit. E.g., *Lewis v. Graves*, 701 F.2d 245 (2d Cir. 1983); *Greenspun v. Del E. Webb Corp.*, 634 F.2d 1204 (9th Cir. 1980); *In re Kauffman Mutual Fund Actions*, 479 F.2d 257 (1st Cir. 1973). Although none of these opinions dispenses with the exception altogether, the day is at hand – unless decisions of the Supreme Court bar the way.

Two decisions, *Doctor v. Harrington*, 196 U.S. 579 (1905), and *Susquehanna*, arguably adopt a futility exception to the demand requirement for purposes of pre-*Erie* general federal law. Although both of these cases speak favorably of a futility exception to the demand requirement, neither prevents the evolution of the federal common law.

Doctor raised the question whether the corporation should be aligned as a plaintiff or a defendant for purposes of diversity jurisdiction. The firm is a defendant to the extent the investor complains that it failed to bring suit; it is a plaintiff to the extent that the derivative suit may end in an order compelling the wrongdoers to pay money to the corporation. *Doctor* holds that the firm should be aligned as a defendant when the board is so hostile to the investors that demand would be futile; otherwise it should be aligned as a plaintiff. Many people (including the Supreme Court in *Susquehanna*, 213 U.S. at 449-50) understood this as implying a futility exception to the demand requirement. Although this may have been a plausible inference, *Doctor* is no longer good law. It was overruled in all but name by *Smith v. Sperling*, 354 U.S. 91

(1957), which holds that in a derivative suit the corporation always should be aligned as a defendant for purposes of determining complete diversity. After *Sperling* "futility" is unimportant. When explaining why it would no longer use the board's refusal to sue as the basis of the alignment decision, the Court gave an explanation equally applicable to the futility exception to the demand rule in general: "To stop and try the charge of wrongdoing [in refusing to sue] is to delve into the merits. That does not seem to us the proper course. It is a time-consuming, wasteful exertion of energy on a preliminary issue in the case. The instant case is a good illustration, for it has been over eight years in the courts on the question of jurisdiction." 354 U.S. at 95.

Susquehanna interprets old Equity Rule 94, which codified the holding of *Hawes*. Rule 94 required demand, leaving no (apparent) room for exceptions. *Susquehanna* holds that the rule was not so inflexible. This *holding* is of no consequence; Rule 94 is no longer with us, having been amended many times in the course of the transformation to Rule 23.1. See *Fox*, 464 U.S. at 530-31 n.5. But the discussion of futility, 213 U.S. at 447-52, may be thought to establish a doctrine independent of the defunct equity rule. If this was the Court's meaning, the decision is nonetheless linked to its time. *Susquehanna* assumed that if the members of the board were implicated in the transaction, or held financial interests in the party to be sued, they would be incompetent to act on a demand. Although that is so as a matter of corporate law, the court did not consider the possibility that a committee of independent directors could act on the demand. Not

until the 1970s did courts hold that an independent committee could act on demands – and control litigation in the name of the corporation – even though a majority of the board was interested in the transaction. Development of the independent committee washed away the assumption on which the discussion in *Susquehanna* depends. The Court has never endorsed a "futility" exception to the demand requirement under current assumptions about the ability of committees to act for boards of directors, and given the statement in *Sperling* about the wastefulness of inquiries into futility we are confident it would not do so.

We conclude that precedent does not prevent us from holding that claims of futility should be tested by *making* the demand rather than by arguing about hypotheticals. If the firm declines to sue, the court can decide whether the board's decision is entitled to respect under state corporate law, which applies in light of the holding of *Burks*. See also *Pepper v. Litton*, 308 U.S. 295, 306 (1939); *Hill v. Wallace*, 259 U.S. 44, 61 (1922); *United Copper*, 244 U.S. at 264. As we have rejected *Zapata*, the making or failure to make a demand will not alter the business judgment standard that ordinarily applies to corporate decisions. Courts now may focus on the question whether the board's actual decision should be given force, rather than on hypothetical inquiries. "Futility" is the only reason Kamen gives for not making a demand on her claim under §20(a). As this is an unsatisfactory reason, we agree with the district court's decision that the claim must be dismissed for failure to make a required demand.

Abolition of the futility exception calls into question our holdings in *Thornton* and *Nussbacher*. *Thornton* was a

suit under ERISA, and the court extensively discussed the policies behind ERISA before deciding that demand would be futile. It may be that *Thornton*, like *Fox*, illustrates our category (c): Demand is not required when under substantive law the board may neither control nor prevent litigation. That question must be left for another day. *Nussbacher*, on the other hand, was founded squarely on the futility exception. The panel held that demand was excused because it was clear from the defendants' motion to dismiss the suit on the merits that demand would have been futile, 518 F.2d at 878-79. *Nussbacher* reasoned that because Rule 23.1 allows the plaintiff to plead reasons why demand is excused, it must follow that the futility of demand is an adequate excuse. In other words, *Nussbacher* treated Rule 23.1 itself as the source of the substantive requirements, a position we repudiated in *Starrels*, applying the rationale of *Burks*. Other decisions regularly hold that the board's defense of the suit on the merits does not justify failure to make demand. E.g., *Grossman v. Johnson*, 674 F.2d 115 (1st Cir. 1982); *Cramer v. GTE Corp.*, 582 F.2d 259, 276 (3d Cir. 1978). Lest *Nussbacher* be thought to represent an independent assessment of the futility exception with continuing vitality, we now formally overrule that case.*

II

After *Fox* the demand requirement of Rule 23.1 does not apply to a claim under §36(b). The Court held that

---

* Because this decision overrules an opinion of this court, it was circulated before release to all judges in active service. See Circuit Rule 40(f). No judge voted to hear the case in banc.

§36(b) creates a right of action that only the investor and the SEC may pursue. Because the mutual fund may not assert a claim against the investment adviser under §36(b), the Court reasoned, Rule 23.1 – which applies only to suits "brought . . . to enforce a right of the corporation . . . , the corporation . . . having failed to enforce a right which may properly be asserted by it" – does not call for a demand on the directors to file suit. What is the point of dunning the directors, if under the statute they may not sue? Our holding with respect to the need for a demand under §20(a) therefore does not affect the claim under §36(b).

A

Judge Aspen dismissed the claim under §36(b) on the basis of Magistrate Balog's conclusion that Kamen is not an adequate representative of other investors in the Fund. Rule 23.1 requires adequacy: "The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association." Yet the very statement of the adequate-representation requirement repeats the theme that Rule 23.1 is limited to suits in which an investor seeks to enforce a *corporate* right. Rule 23.1 imposes hurdles, including both the pleading requirement and the adequate-representation requirement, before a court will strip the directors of their entitlement to manage the affairs of the corporation, including their right to control the pursuit or compromise of its legal claims. *Fox* holds that a claim under §36(b) is *not* a claim "of the corporation", and it follows that Rule

23.1 is inapplicable. Demand requirements and adequate-representation requirements go hand in glove. If the claim under §36(b) is really the investor's *personal* claim, it is unimportant whether Kamen "adequately" represents other investors. Under the statute, she need represent no one.

Kemper relies on footnote 11 of *Fox*, 464 U.S. at 535 n.11, which allows that a suit under §36(b) is "undeniably 'derivative' in the broad sense of that word", because the fiduciary obligation runs to the mutual fund, which will receive any remedy. True enough, but it is of no assistance to defendants. Rule 23.1 does not ask whether a suit is derivative "in the broad sense of that word". It asks whether the suit seeks to enforce a right of the corporation, "the corporation . . . having failed to enforce a right which may properly be asserted by it". *Fox* holds that the claim under §36(b) is not one the corporation may assert. It therefore establishes that Rule 23.1 does not apply, period. The opinion could hardly be clearer. At pages 528, 535 n.11, and again in stating the holding at 542, the Court quotes this language of Rule 23.1 and observes that §36(b) litigation does not fall within the domain of the rule. Lest there be any doubt, the last sentence reads:

> It follows that Rule 23.1 does not apply to an action brought by a shareholder under §36(b) of the Investment Company Act and that the plaintiff in such a case need not first make a demand upon the fund's directors before bringing suit.

464 U.S. at 542. Kamen filed a suit under §36(b), and Rule 23.1 therefore "does not apply". In *Fox* that meant no demand; here it means no need for adequate representation. See also *Pellegrino v. Nesbitt*, 203 F.2d 463 (9th Cir.

1953) (similar conclusion with respect to the short-swing-profit-recovery provision of §16(b) of the Securities Exchange Act of 1934).

If Rule 23.1 does not require adequate representation, defendants maintain, then the due process clause of the fifth amendment must. Due process requires adequate representation, though, only when the plaintiff is *representing* someone else. A judgment in a class action will bind persons who are not before the court. Before resolving the legal entitlements of missing persons, the court must ensure that they have an effective voice. *Hansberry v. Lee*, 311 U.S. 32, 41-42 (1940). Kamen represents no one other than herself. *Fox* establishes that the right at stake is personal; she does not need the approval of the court or other investors to pursue it. Doubtless other investors are interested in the result, yet many suits affect the status of others as a practical matter without triggering a constitutional requirement of "adequate representation".

Rules 19 and 24 are designed for such cases. Rule 19 allows and sometimes requires the joinder of persons who will be affected by a judgment; Rule 24 allows intervention. Defendants do not maintain that Rule 19 requires the joinder of other investors. Rule 24 may allow them to intervene on the other side to argue for or against Kemper's management fees. *Bethume Plaza, Inc. v. Lumpkin*, 863 F.2d 515, 531-34 (7th Cir. 1988). None has done so, undoubtedly because investors who support the current fee structure believe that they already have adequate champions: Kemper and the Fund. What is more, a judgment against the defendants requiring a reduction in the level of fees would not "bind" other investors any more than a judgment in a contract or tort suit "binds" the

investors and employees of the firm required to pay damages. If the court should deem the fees excessive, and the Fund then cut back on services, shareholders may take their money elsewhere. That would injure the Fund and Kemper, which as parties represent themselves. It might also reduce the consumers' surplus of the investors (the value they place on the Fund's services, less the price they pay), but such an indirect consequence does not require either actual or vicarious representation in the litigation. See *O'Bannon v. Town Court Nursing Center*, 447 U.S. 773, 778-89 (1980).

B

At all events, Kamen is no less adequate a representative than are most plaintiffs in class actions. Securities actions, like many suits under Rule 23, are lawyers' vehicles. Investors diversify their holdings, so it is no surprise that Kamen, like most plaintiffs in securities cases, does not hold very much stock in the defendants and has delegated the investigation and prosecution of the suit to counsel. Class actions are valuable precisely because they allow the vindication of claims too small to prosecute individually but worth litigating in the aggregate. See *In re American Reserve Corp.*, 840 F.2d 487 (7th Cir. 1988). When defendants' counsel took Kamen's deposition and learned that she knew little about either the Fund or the case and had given counsel free reign, they learned only that this case fits the norm. Securities markets function efficiently because of the division of labor; legal markets also rely on specialization. Kamen did not need to immerse herself in the mutual fund business to qualify as a plaintiff. *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363

(1966); *Lewis v. Curtis*, 671 F.2d 779, 788-89 (3d Cir. 1982). Counsel to whom Kamen entrusted the litigation – perhaps more accurately, who found Kamen to wage the litigation – is a specialist in the field, having argued and won *Fox* in the Supreme Court. There can be no doubt that Kamen's champion will advocate the claim vigorously and skilfully [sic].

Magistrate Balog's conclusion that Kamen has only a private grievance misses the point. Kamen is not trying to get even because she bears a grudge – say, because a member of the Fund's board trampled her petunias. She seeks a higher rate of return on her investment. So do all other shareholders in the Fund. It may well be that most other shareholders believe that the Fund's special services are worth the 0.2% cost, but shareholders have a common interest in ensuring that the Fund pays Kemper no more than the extra services are worth. Commonality of interest is the essence of adequate representation. *Sosna v. Iowa*, 419 U.S. 393, 403 (1975). If the services make a 0.2% premium fee "excessive", the defendants will prevail on the merits. If the services do not justify the incremental fee, then all shareholders will gain from a decision.

Given that Kamen and other investors win or lose together, the adequacy of her representation (more realistically, of her lawyer's) matters if the suit is strong. Suppose the Fund has a well-grounded claim against Kemper for $40 million in excessive fees. A feeble litigant, or one willing to sell out for satisfaction of her personal claim, would injure other investors in the Fund by extinguishing the claim against Kemper without producing its full value for the Fund. Other investors therefore could

be worried that the first one to step forward and sue will be insufficiently vigorous, or have divided loyalties. No such investor has appeared to complain that Kamen will do too little for them, and neither the Fund nor Kemper seems worried that Kamen will under-prosecute this suit. Why is it that the *defendants* insist that the plaintiff is a poor representative of the other stockholders? Perhaps defendants fear that Kamen will be too vigorous?

Defendants' principal fear is not of inadequate representation but of legal error – that a court playing rate regulator may think the fees excessive even when they are not. Such a mistake would injure all investors, and the injury would fall more heavily on investors other than Kamen who use the sweeps and redemption services the Fund provides. Kamen would find other money market funds suited to her passive investment strategy; active investors would be especially aggrieved by a cutback in services. In this sense, even though Kamen's interests are the same as those of other investors – all want the fund to pay no more than the market price for the services Kemper renders – Kamen has less to fear from an error and therefore is not the optimal champion. Still, such differences in incentives pervade class actions. Even if the members of the class were perfectly homogeneous (they never are), the representative's small stake might lead her to settle for too little or to press arguments that favored her position (or her attorney's) at the potential expense of those she represents. See Kenneth W. Dam, *Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest*, 4 J. Legal Studies 47 (1975); Andrew Rosenfield, *An Empirical Test of Class-Action Settlement*, 5 J. Legal Studies 113 (1976). Agency costs of this kind, even when coupled

with differential sensitivity to error costs, are not the same as concrete conflict of interest between the "representative" and other members of the class. They inhere in representative actions. The real bogies, the costs of defense and the risk of error, haunt all litigation. False positives and the potential for self-serving conduct are endemic to the system under §36(b); the costs of legal error in regulating prices are attributable to the existence of §36(b) and not to the selection of Kamen as a plaintiff.

Although the investors by majority vote approved Kemper's fees in 1986, the vote was not unanimous. Of the 5.3 billion shares of the Fund's money market portfolio in 1986, 2.97 billion were voted at the meeting (almost all by proxy). Approximately 2.44 billion were voted for the management agreement, 364 million against, and 169 million abstaining. The contract was ratified, then, by 82% of the shares present at the meeting, although only 46% of the outstanding shares. These figures do not suggest that Kamen is in a teensy minority; she had as of 1986 the company of the holders of 364 million shares of the Fund. Section 36(b)(2) provides that investors' approval of a management fee should inform the court's judgment on the merits; it does not imply that approval forecloses suit by one of the dissenters – if it did, §36(b) would be dead, for *all* fees challenged under the statute have been approved by the investors at one or another time. So, too, it is not dispositive that none of the other investors has intervened to support Kamen's suit. Many a class action proceeds with a single representative; conservation on the number of litigants is a virtue of the device. Even if this were a case in which the plaintiff must

represent others "adequately", then, Kamen would be a proper plaintiff.

III

Because the action may proceed under §36(b), we need to decide whether Kamen is entitled to a jury trial in the event there are disputed issues of material fact. Judge Nordberg held not, following *In re Evangelist*, 760 F.2d 27 (1st Cir. 1985), *Schuyt v. Rowe Price Prime Reserve Fund, Inc.*, 835 F.2d 45 (2d Cir. 1987), and *Krinsk v. Fund Asset Management, Inc.*, 875 F.2d 404, 414 (2d Cir. 1989). These opinions hold that the action authorized by §36(b) is not a "suit[ ] at common law" within the meaning of the seventh amendment because the statute creates a fiduciary duty and recovery "shall in no event exceed the amount of compensation or payments received from [the] investment company", §36(b)(3). A combination of fiduciary duty with a remedy of cancellation and restitution is traditionally equitable.

Novel statutes such as §36(b), establishing requirements and procedures that *Fox* repeatedly called "unique", do not fit well into a constitutional framework requiring the rights to jury trial as of 1791 to be "preserved". Federal courts abolished the distinction between law and equity with the adoption of the Rules of Civil Procedure in 1938, and changes in both the nature of legal rights and the preferred remedies make it difficult to reconstruct what our forbears would have seen as "common law". See Douglas G. Baird, *The Seventh Amendment and Jury Trials in Bankruptcy*, 1989 Sup. Ct. Rev. 261. No rights comparable to those of §36(b) existed two centuries

ago; the closest equitable action dealt with corporate "waste" and not with determining whether prices are reasonable. Although enforcing fiduciary duties was equitable in English practice, awarding damages was a job for a common law court. Squeezing a hybrid action into one category or the other is bound to cause friction. Recognizing that no answer can be wholly satisfactory, and not wanting to add unnecessarily to the clutter of opinions on the subject, we adopt both the holding and rationale of *Evangelist*.

One case postdating the First and Second Circuits' decisions calls for comment. *Teamsters Local No. 391 v. Terry*, 110 S. Ct. 1339 (1990), holds that a suit alleging that a union breached its duty of fair representation, and requesting damages measured by the amount of back pay, is "at common law" for constitutional purposes and so allows either side to demand a jury. The Court rejected an argument that the foundation of the suit on a breach of the union's fiduciary duty to its members was sufficient to render it "equitable". Even the fillip that the remedy would be measured by the amount of pay lost, a yardstick from the courts of equity, did not suffice. *Terry* appears to call into question the foundation for *Evangelist* and similar holdings about §36(b).

Although any prediction is hazardous, we conclude that the Court would think an action under §36(b) equitable under the analysis it used in *Terry*. Seven Justices accepted the proposition, central to cases such as *Evangelist*, that "an action by a trust beneficiary against a trustee for a breach of fiduciary duty" is equitable because it was "within the exclusive jurisdiction of the courts of equity" in 1791. 110 S.Ct. at 1346 (plurality opinion); see also *id.* at

1355 (Kennedy, J., dissenting). The investment adviser is not a "trustee", and the relation between fund and adviser is contractual rather than one in which the beneficiary of the trust lacks authority to choose the trustee; still, the statute creates a fiduciary duty and enforces it with a remedy (disgorgement) common in trust cases.

The analogy between the union's duty and a trustee's broke down in *Terry* because the union was supposed to be enforcing a contract, and the claim against the union depended on proof that the employer broke its contract. The remedy, although measured by pay lost, came from the union rather than the employer, which made it look more like damages than restitution. An action under §36(b), quite unlike the action for a breach of the duty of fair representation, is one to annul a contract rather than to enforce it. Reformation or cancellation of a contract was equitable in 1791 and until the distinction between law and equity broke down in this century. Restitution under §36(b) comes from the party that received the benefits, which further separates this case from *Terry*. Four different opinions in *Terry*, advocating four different approaches to the constitutional question, render parlous any predictions. Nonetheless, the combination of a fiduciary duty with a restitutionary remedy in §36(b) continues to put this statute on the equitable side of the constitutional line.

The judgment of the district court is affirmed in part, reversed in part, and remanded for further proceedings on the claim under §36(b).

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

Memorandum Opinion and Order

IN THE
UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 85 C 4587 - Judge John A. Nordberg

JILL S. KAMEN,

Plaintiff,

v.

KEMPER FINANCIAL SERVICES, INC., and
CASH EQUIVALENT FUND, INC.,

Defendants.

MEMORANDUM OPINION AND ORDER

The plaintiff, Jill Kamen, is a shareholder in Cash Equivalent Fund, Inc. ("the Fund"), a money market mutual fund managed and administered by Kemper Financial Services, Inc. ("KFS"). Plaintiff instituted this shareholder's derivative action pursuant to the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.* ("ICA" or "the Act"), challenging the fees charged by KFS for managing and administering the Fund. She alleges that KFS solicited a misleading proxy in violation of § 20(a) of the Act, 15 U.S.C. § 80a-20(a), and that KFS' excessive fees constitute a breach of its fiduciary duty in violation of § 36(b) of the Act. 15 U.S.C. § 80a-35(b).[1]

[1] This court has jurisdiction pursuant to § 44 of the Act, 15 U.S.C. § 80a-43.

Defendants move to dismiss plaintiff's § 20(a) claims for failure to state a cause of action and for failure to make a demand on the Board of Directors as required by Fed.R.Civ.P. 23.1; and to strike plaintiff's jury demand. For the following reasons, the court grants the motions to dismiss and to strike the jury demand.

Factual Allegations

The facts, as alleged in the complaint,[2] are as follows. The Fund is a diversified open-end investment company registered with the Securities and Exchange Commission under the ICA. It invests in a range of short-term money market instruments with maturities of one year or less. The Fund commenced operations on March 16, 1979, and, as of April 23, 1985, its total assets were approximately $4.683 billion.

KFS has acted as the Fund's investment adviser, manager, primary administrator and underwriter since the Fund's inception. In exchange for its services, KFS receives monthly fees paid under two separate agreements. The investment management agreement provides for an investment management fee calculated at the annual rate of .22 of 1% of the first $500 million of the combined average daily net assets of the portfolios managed by KFS, .20 of 1% of the next $500 million, .175 of 1% of the next $1 billion, .16 of 1% of the next $1 billion

[2] On a motion to dismiss, the court must accept all well pleaded facts as true, and must make all reasonable inferences in the light most favorable to the plaintiff. *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S.Ct. 99, 102 (1957); *City of Milwaukee v. Saxbe*, 546 F.2d 693, 704 (7th Cir. 1976).

and .15 of 1% of average daily net assets of such portfolios over $3 billion. The administration, shareholder services and distribution agreement ("administration agreement") provides for an annual fee, payable monthly, on a basis of .33% of the first $500 million of average daily net assets, .30% of the next $500 million, .275% of the next $1 billion, .265% of the next $1 billion, and .25% of average daily net assets over $3 billion.

The Fund has experienced tremendous success in attracting shareholder funds in the past several years, which has caused a significant increase in the total fees payable to KFS under the two separate agreements. For the fiscal year ended July 31, 1984, the Fund paid KFS nearly $20 million in fees.[3]

The essence of plaintiff's complaint is that these fees are excessive, given the nature of the Fund and the services performed by KFS. Plaintiff alleges that, unlike other mutual funds, the management of the assets of a money market fund "does not require the detailed analysis of industries nor of complex industrial companies and the concomitant retention of a large staff of highly paid and sophisticated securities analysts [because] the assets of the Fund are . . . invested in a relatively concentrated manner in fixed income obligations maturing in one year or less." (Compl. ¶9).[4] Despite the huge growth

[3] Kamen filed a supplemental complaint on December 8, 1986. This complaint alleges that the Fund's Board of Directors amended KFS' administration agreement in November of 1986 to substantially increase the fees paid to KFS.

[4] Paragraph 14 alleges:

> Because of the limited number, nature and variety of the Fund's investments, the investment decisions of

(Continued on following page)

of the Fund and the manner in which it is serviced, the fee structure has remained the same since December 1, 1981, when the fees were increased by virtue of the administration agreement. According to Kamen, the increased compensation paid to KFS resulting from the enormous increase in Fund assets is disproportionate to the services rendered by it. These allegations form the basis of Kamen's excessive fee claim under § 36(b) of the Act, 15 U.S.C. § 80a-35(b).

Kamen also alleges that KFS violated § 20 of the ICA, 15 U.S.C. § 80a-20, which proscribes the solicitation of misleading proxies in connection with a security of a registered investment company.[5] In addition to the Fund,

---

(Continued from previous page)

the Fund can be made by a single person, or, at most, a handful of persons. The research and advisory activities of KFS are merely routine and administrative in nature, do not require any significant expertise or investment acumen, are performed (and were performed prior to the formation of the Fund) by KFS for other of its accounts, and consist principally of purchasing and 'turning over' money market instruments with a limited number of institutions. The incremental cost to KFS of performing these services for the Fund is minimal. In short, the investment advice provided by KFS is not worth the fees paid for that advice by the Fund and has not been worth the fees paid during the period covered by this complaint. Other advisers performed and have performed similar or superior services for lesser rates.

[5] 15 U.S.C. § 80-20(a) provides in pertinent part:

It shall be unlawful for any person, by use of the mails or any means of instrumentality of interstate

(Continued on following page)

KFS also acts as an investment manager to the Kemper Money Market Fund, Inc. ("MM"), a money market fund which is similar to the Fund in size, number of shareholders, and investment objective. MM and the Fund have some common directors, and require substantially the same services from KFS. According to Kamen, despite this similarity in size and objective, KFS exacts substantially greater fees from the Fund than it does from MM and many of its other clients.[6]

Kamen further alleges that, on or about September 12, 1984, KFS caused a proxy statement to be distributed to the shareholders for the annual meeting of shareholders scheduled for November 8, 1984. One of the purposes of the meeting was to obtain shareholder

---

(Continued from previous page)

commerce or otherwise, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect to any security of which a registered investment company is the issuer in contravention of such rules and regulations of the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 20a-1 renders the rules and regulations promulgated by the SEC pursuant to § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C § 78n. applicable to misleading proxy claims under § 20(a) of the ICA. 17 C.F.R. 270.20a-1.

[6] Kamen alleges that in the Fund's expenses in the year ended July 31, 1984 .72% of its average net assets, while MM's expenses were only .53% of its average net assets. As a result, the Fund's yield for the year ended September 30, 1984 was approximately 21 basis points less than that of MM. (Compl. ¶ 12).

approval for the continuance of the investment management agreement with KFS. The proxy statement seeking shareholder approval of the investment management agreement compared the fees that KFS received from other investment companies to those paid by the Fund. Kamen alleges that, although the proxy correctly compared, the services rendered to the Fund to those rendered to MM, it "misleadingly" described MM's fees as a maximum fee of .50 of 1% of the first $215 billion [sic], with lesser rates of additional assets." This "misleading" description gave the false impression that MM's fees were as high or higher than those paid by the Fund, when KFS knew that the opposite was actually true. The proxy solicitation was successful, and KFS obtained shareholder approval for continuation of its investment management agreement with the Fund.

As the above allegations clearly demonstrate, the thrust of Kamen's § 20(a) claim is that KFS disseminated misleading proxies in order to obtain continued shareholder approval for allegedly exorbitant fees. KFS' motion to dismiss concerns only the § 20(a) claims. It urges dismissal of this claim on two grounds: first, because Kamen failed to make a demand on the Fund's directors, as required by Fed.R.Civ.P. 23.1; and second, because § 36(b) of the Act provides the exclusive remedy for excessive fees. For the following reasons, the court finds that, although the complaint properly alleges a cause of action under § 20(a), it must be dismissed because Kamen failed to comply with the demand requirements of Rule 23.1.

Claims under § 20 of ICA

KFS argues that ¶ 13 of the complaint, which alleges violations of § 20(a) of the ICA, 15 U.S.C § 81a-20(a), must be dismissed because § 36(b) provides the exclusive remedy for shareholder claims alleging excessive fees. Section 20(a) of the ICA forbids the dissemination of misleading information in proxies solicited from mutual fund shareholders. Section 36(b) of the Act, which was passed in 1970,[7] authorizes a shareholder's suit to recover excessive fees from a fund's investment adviser. Congress added this section in order to remedy the fact that the Act, as originally passed, failed to "provide any mechanism by which the fairness of management contracts [between a fund and its adviser] could be tested in court." S.Rep. No. 91-184, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Admin. News 4897, 4901. Section 36(b) creates a fiduciary duty on the part of the adviser "with respect to compensation for services or other payments paid by the fund . . . to the advisers," *id.*, and authorizes shareholders to sue for breach of that fiduciary duty. *See generally Daily Income Fund, Inc. v. Fox*, 104 S.Ct. 831 (1984).

Prior to the passage of § 36(b), the Second Circuit had recognized an implied cause of action under the ICA for misleading proxy statements. *See Brown v. Bullock*, 194 F.Supp. 207, 231-34 (S.D. N.Y), *aff'd*, 294 F.2d 415, 420-21 (2d Cir. 1961).[8] It continued to recognize an implied cause

---

[7] Section 20(a) was part of the original Investment Company Act passed in 1940.

[8] All of the cases discussing an implied right of action under § 20(a) have arisen in the Second Circuit.

of action for § 20(a) claims unrelated to allegations of excessive fees after the passage of the 1970 amendments. *Tannenbaum v. Zeller,* 552 F.2d 402 (2d Cir.), *cert. denied,* 434 U.S. 934, 98 S.Ct. 421 (1977); *Galfand v. Chestnutt Corp.,* 545 F.2d 807 (2d Cir. 1976); *Rosenfeld v. E.R. Black,* 445 F.2d 1337 (2d Cir. 1971). In *Fogel v. Chestnutt Corp.,* 668 F.2d 100, 112 (2d Cir. 1981), *cert. denied,* 459 U.S. 828, 103 S.Ct. 65 (1982), however, the court noted in dictum that § 36(b) may constitute a shareholder's exclusive remedy for his claims of excessive fees.

Although some district courts seized on the language in *Fogel* to disallow implied claims for excessive fees under the ICA,[9] a recent decision has recognized a claim under § 20(a) of the ICA in a situation involving facts very similar to the case at bar. In *Schuyt v. Rowe Price Prime Reserve Fund, Inc.,* 622 F.Supp. 169 (S.D. N.Y. 1985), the plaintiff-shareholder alleged that the management fee paid to the fund's adviser was excessive (36(b) claim) and that the defendants violated § 20(a) because the proxies soliciting shareholder approval of the management contract were misleading. The plaintiff sought repayment of the excessive fees under the § 36(b) claim, and sought profits and/or reimbursements for the amounts paid under the agreements obtained through the misleading proxy. *Schuyt,* 622 F.Supp. at 171. The defendants sought dismissal of the § 20(a) claim on the ground that § 36(b)

[9] *See, e.g., Gartenberg v. Merrill Lynch Asset Management, Inc.,* 528 F.Supp. 1038, 1067 (S.D. N.Y. 1981), *aff'd,* 694 F.2d 923 (2d Cir. 1982), *cert. denied,* 461 U.S. 906, 103 S.Ct. 1877 (1983) (*"Gartenberg I"*); *Tarlov v. Paine Webber Cash Fund, Inc.,* 559 F.Supp. 429, 437 (D. Conn. 1983).

provided the exclusive remedy for plaintiff's excessive fee claims.

The court rejected Rowe Price's argument that Schuyt's § 20(a) claim was " 'an excessive fee claim dressed in slightly different clothes' " *Id.* at 173-74. It noted:

> Count III of the Third Amended Complaint does not allege *solely* that advisory fees paid by the Fund to Price Associates were excessive. The § 20(a) claim raised in Count III advances distinct factual allegations of material non-disclosures in particular proxy statements, and seeks legal and equitable relief beyond the mere recapture of excessive fees. Because it cannot fairly be characterized as a claim that alleges *solely* a breach of fiduciary duty arising from excessive compensation paid to an investment adviser, plaintiff's § 20(a) claim does not fall with the narrow category of claims that the Second Circuit panel in *Fogel v. Chestnutt, supra,* thought might properly be brought only under § 36(b)

Id. at 174 (emphasis in original). In the present case, Kamen has not denominated her claims in separate counts.[10] However, it is clear from the pleadings that she seeks damages for the alleged § 20(a) violation and reimbursement of excessive fees for the § 36(b) claim. The factual allegations of misleading proxy statements are distinct from the fiduciary breach allegations. Both

[10] In this respect, Kamen's complaint fails to satisfy the requirements of Fed.R.Civ.P. 10(b), which requires "that each claim founded upon a separate transaction or occurrence . . . shall be stated in a separate count."

address a distinct form of cupable [sic] conduct separately redressable under the ICA. Following *Schuyt*, the court finds that Kamen should be able to pursue both claims in this lawsuit.

The Supreme Court recently decided a similar issue in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 103 S.Ct. 683 (1983). In that case, the plaintiff alleged that defendants issued a misleading registration statement, and filed suit under § 10(b) of the Securities Exchange Act of 1934 and § 11 of the Securities Act of 1933. The defendants sought dismissal of the implied action under § 10(b) on the grounds that § 11 provided the exclusive remedy for misrepresentations relating to registration statements. The Supreme Court noted that these two provisions involve distinct causes of action, and were intended to address different wrongdoings. Thus, although the evidence supporting the two claims might overlap, this fact, in and of itself, was insufficient to preclude plaintiff from pursuing both claims. 495 U.S. at 381, 103 S.Ct. at 686.

This analysis applies with equal force to KFS' argument that § 36(b) provides the sole remedy for excessive fees. Section 20(a) was enacted in order to ensure complete and adequate disclosures in proxy materials solicited from mutual fund shareholders. Patterned after § 14 of the Securities Exchange Act of 1934, it prohibits dissemination of misleading proxies. In order to recover for a violation of this section, the plaintiff must establish "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of the information available." *TSC Industries, Inc. v. Northway, Inc.*,

426 U.S. 438, 449, 96 S.Ct. 2126, 2133 (1976). In contrast, a plaintiff in a § 36(b) suit must prove a breach of fiduciary duty on the part of the investment adviser. 15 U.S.C. § 80a-35(b)(1). Proof of misrepresentations may assist the plaintiff in his burden of proof, but a plaintiff need not establish the existence of misrepresentations in order to prevail on a § 36(b) claim. To prove a § 36(b) violation, the plaintiff must demonstrate that the adviser charges a fee "that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arms length bargaining." *Gartenberg I*, 694 F.2d at 928. Thus, although a violation of § 20(a) may be relevant to a § 36(b) claim, it clearly exists independent of that claim. *See Schuyt*, 622 F.Supp. at 176-177.[11] Following *Huddleston*, there is no reason to carve out an exception to the well-recognized implied cause of action from misleading proxy statements under § (a) of the ICA.

Contrary to KFS' argument, the legislative history of the passage of § 36(b) does not evidence a Congressional intent to preclude other suits to recover excessive fees based on wrongdoings prohibited by other sections of the

---

[11] The court disagrees with KFS's argument that allowing § 20(a) claims in the context of excessive fee suits would thwart the intent of Congress when it passed § 36(b). According to KFS, allowance of a § 20(a) claim would undermine the procedural restrictions contained in § 36(b). What KFS fails to acknowledge is that a § 20(a) claim exists independent of a § 36(b) claim, and involves different elements of proof. Not all § 36(b) claims involve misleading proxies and a plaintiff needs a misrepresentation in a proxy statement if she wishes to proceed under § 20(a).

ICA. In *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353, 378-79, 102 S.Ct. 1825, 1839 (1982), the Court held that when Congress amends a pre-existing law, the proper inquiry is not whether Congress intended to create a private remedy to supplement the express remedy, but rather, whether "Congress intended to *preserve* the preexisting remedy." (emphasis supplied). Prior to the passage of § 36(b), the courts had recognized an implied right of action for claims related to the procurement of an advisory contract which permits excessive fees. *Brown v. Bullock*, 294 F.2d 415 (2d Cir. 1961). *Cf. J.I. Case v. Borak*, 377 U.S. 426, 84 S.Ct. 1555 (1964) (recognizing an implied cause of action under § 14 of the Securities Exchange Act of 1934). This court agrees with the *Schuyt* court's conclusion that "nothing in the statute or legislative history indicates that Congress intended to preclude a mutual fund shareholder from joining a § 36(b) claim for excessive fees with claims for breach of other fiduciary duties or for other distinct violations of the ICA." *Schuyt*, 622 F.Supp. at 177 (footnote omitted). *See Krome v. Merrill Lynch & Co., Inc.*, 637 F.Supp. 910, 917-20 (S.D. N.Y. 1986); Note, *Implied Private Rights of Action under the Investment Company Act of 1940*, 40 Wash. & Lee L.Rev. 1069, 1085-86 (1983).

KFS relies primarily on *Gartenberg I* to support its argument that § 36(b) provides the exclusive remedy for excessive fee claims. *Gartenberg I* provides little support for the argument that § 20(a) claims cannot be joined with claims under § 36(b). In *Gartenberg I*, the plaintiff did not raise the issue of alleged violations of § 20(a) until after the court had completed a bench trial on his § 36(b) claims. This district court dismissed this belated claim

because the alleged misstatements were not misleading. 528 F.Supp. at 1066. It added, "[i]n any event, . . . § 20(a) of the Act w[as] not intended to and do[es] not establish a private right of action in the context of a claim such as here for recovery of compensation under § 36(b)." *Id.* at 1067. On Appeal, the Second Circuit affirmed the District Court's findings with respect to Gartenberg's § 36(b) claims. 694 F.2d at 930-33. The court also affirmed the district court's dismissal of the belated § 20(a) claims because they were not properly before the district court for adjudication. It added, "[i]n any event, for the reasons already expressed by us and the additional reasons stated by the district court in its discussion of these additional claims, . . . they are meritless." 694 F.2d at 934.

The *Gartenberg* plaintiffs filed a second case after the Second Circuit issues its decision in *Gartenberg I*. *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 573 F.Supp. 1293 (S.D. N.Y. 1983), *aff'd*, 740 F.2d 190 (2d Cir. 1984) (*"Gartenberg II"*). In *Gartenberg II*, the plaintiffs raised claims under both § 20(a) and § 36(b). The case was assigned to the same district judge who tried *Gartenberg I*. It is noteworthy that this judge tried both claims, without mention of his statement in *Gartenberg I* that § 36(b) might preclude § 20(a) claims based on misleading proxies used to authorize excessive fees. *Gartenberg II*, 573 F.Supp. at 1307 (discussing merits of § 20(a) claim). The *Gartenberg II* affirmance also fails to refer to the court's earlier statement that § 36(b) precludes § 20(a) claims in this type of case.

In *Schuyt*, the court noted the same distinction between the treatment of § 20(a) claims in *Gartenberg I* and *Gartenberg II*. It concluded:

> [The District Court's] strikingly different treatment of the two § 20(a) claims raised in *Gartenberg II* strongly suggests that his rejection at [the] § 20(a) claim in *Gartenberg I* and *II* resulted from the defects peculiar to that claim and not from a defect generic to all § 20(a) claims joined with a claim for excessive fees.

Schuyt, 622 F.Supp. at 176.[12] This court agrees that the court's comments in *Gartenberg I* must be viewed in the context of that case. Given the Second Circuit's acknowledgment of § 20(a) claims after *Gartenberg I*, the court finds that this case provides scant support to KFS' argument that § 20(a) claims can never be raised in connection with a § 36(b) suit for excessive fees.

For the reasons set forth above, the court finds that the passage of § 36(b) does not preclude a claim under § 20(a) which alleges that the management contract was secured through a misleading proxy. Therefore, the court denies KFS' motion to dismiss Kamen's § 20(a) claim for failure to state a cause of action.

Rule 23.1's Demand Requirement

This complaint was filed as a shareholder's derivative action in which Kamen seeks to sue on behalf of the Fund to recover excessive fees allegedly paid to KFS. Rule 23.1, which governs derivative actions, provides:

[12] The court notes that the Second Circuit has issued another decision subsequent to *Gartenberg II* which allowed § 20(a) claims without mention of the possible limitation imposed by § 36(b). *See Meyer v. Oppenheimer Management Corp.*, 764 F.2d 76 (2d Cir. 1985).

> In a derivative action brought by [a] shareholder . . . to enforce a right of a corporation, . . . having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors, . . . and the reasons for his failure to obtain the action or for not making the effort.

In *Daily Income Fund, Inc. v. Fox*, 104 S.Ct. 831, 841 (1984), the Supreme Court held that Rule 23.1's demand requirement is inapplicable to shareholder suits challenging excessive advisory fees under § 36(b). KFS acknowledges that Kamen's § 36(b) claims cannot be dismissed for noncompliance with Rule 23.1; however, it urges the court to dismiss the § 20(a) claims, which are not implicated by the *Fox* decision, because Kamen failed to make a demand on the Fund's Board of Directors in accordance with Rule 23.1.

The purpose of Rule 23.1's demand requirement is to notify directors of a potential claim, so that they may investigate it and pursue intracorporate remedies before a court intervenes at a shareholder's request. *Thornton v. Evans*, 692 F.2d 1064, 1080 (7th Cir. 1982); *Mills v. Esmark, Inc.*, 91 F.R.D. 70, 72 (N.D. Ill. 1981). The demand requirement stems from the recognition that "derivative actions brought by minority stockholders could, if unconstrained, undermine the basic principle of corporate governance that the decisions of a corporation – including the decision to initiate litigation – should be made by the board of directors or the majority of shareholders." *Daily Income Fund, Inc. v. Fox*, 104 S.Ct. 831, 836 (1984). Rule 23.1's limitations are "designed to limit the use of the

[shareholders' derivative suit] to situations in which, due to an unjustified failure of the corporation to act for itself, it [is] appropriate to permit a shareholder 'to institute and conduct litigation which usually belongs to the corporation.' " *Id.*, citing *Hawes v. City of Oakland*, 104 U.S. 450, 460, 26 L.Ed. 827 (1882).

The rationale underlying Rule 23.1's demand requirement is two-fold: first, the courts presume that management is in a superior position to assess the merits of a particular claim; and second, assuming the claim is valid, the corporation may possess superior financial resources with which to pursue the litigation. *Lewis v. Anselmi*, 564 F.Supp. 768, 771 (S.D. N.Y. 1983); *Abrams v. Mayflower Investors, Inc.*, 62 F.R.D. 361, 369 (N.D. Ill. 1974). The "futility" exception to the demand requirement recognizes that there are circumstances where a demand would be a useless gesture, given the relationship between the board of directors and the alleged illegal transaction. Accordingly, Rule 23.1 permits a court to excuse the failure to make a demand if the plaintiff alleges with particularity specific circumstances which indicate that the directors would have ignored her complaints or refused to take any action on them. *See generally Nussbacher v. Continental Illinois National Bank & Trust Co. of Chicago*, 518 F.2d 873, 875 (7th Cir.), *cert. denied*, 424 U.S. 928, 96 S.Ct. 1142 (1976) (plaintiff's failure to make formal demand excused because plaintiff was told directly that the directors would not assist her in any way); *In re Kauffman Mutual Funds, Inc.*, 479 F.2d 257, 264-65 (1st Cir.), *cert. denied*, 414 U.S. 857, 94 S.Ct. 161 (1973) (allegations of self-interest or bias may excuse demand); *Untermeyer v. Fidelity Daily Income Trust*, 79 F.R.D. 36, 42 (D. Mass.), *vacated*, 580 F.2d 22 (1st Cir. 1978) (plaintiff should allege facts which show an "unmistakeable antagonism between the trustees and the corporate interests").

It is undisputed that Kamen failed to make a demand on the Fund's Board of Directors. Although the original complaint did not provide any excuse for this non-compliance with Rule 23.1, Kamen has corrected this error by filing an amended complaint which alleges that resort to the Fund's Board of Directors was not attempted because it would have been futile. Paragraph 17 of the Amended Complaint alleges the following facts in support of Kamen's futility claim:

> (a) With respect to the claims asserted under § 36(b) of the Act, no such demand is required;
>
> (b) The board of directors of the Fund consists of ten members. Of these, three are "interested" as defined by the Act; that is, they have a personal financial interest in KFS. In addition, the president of the Fund, John Hawkinson, was formerly president of KFS and is a stockholder of Kemper Corporation, KFS's parent. Furthermore, the so-called "non-interested" directors currently receive aggregate remuneration of approximately $300,000 a year for serving as directors of the Fund and of all of the other funds in the Kemper group. They are dependent upon and subservient to KFS and Kemper Corporation, its parent;
>
> (c) The proxy statement referred to in paragraph 13 above stated: "the accompanying proxy is solicited by the Board of Directors of the Fund . . . ", and indeed, the directors did vote, without dissent, to distribute the proxy statement to Fund shareholders. Any suit, such as the instant suit, brought to establish liability for the material false statements contained in

that proxy statement would, if successful, tend to establish culpability and liability on the part of all of the directors of the Fund;

(d) Requiring the plaintiff to make a demand on the Fund or its directors to institute or prosecute this action would be futile. It would be tantamount to asking the directors to sue themselves. Moreover, were the directors to accept such an invitation and institute an action, the prosecution of the action would be in hostile hands inimical to its success;

(e) All of the directors, and the Fund itself, as well as its personnel and policies, are under the control of KFS and Kemper Corporation, its parent;

(f) In responding to the original complaint, the Fund, both in its answer and motion to dismiss, has sought the dismissal of the complaint on substantive grounds;

(g) Under all of the circumstances present in this case, application of a demand requirement would be inconsistent with the federal policy underlying § 20 of the Investment Company Act.

The court finds that, although subsection (a) correctly explains the applicability of Rule 23.1 to the § 36(b) claim, subsections (b) through (g) are insufficient to satisfy the pleading requirements of Rule 23.1.

Rule 23.1 requires a plaintiff to allege facts excusing her failure to make a demand "with particularity." This requirement " 'represents a deliberate departure from the relaxed policy of notice pleading promoted elsewhere in the Federal Rules.' " *Grossman v. Johnson*, 89 F.R.D. 656, 659 (D. Mass. 1981); *aff'd.* 674 F.2d 115 (1st Cir.), *cert. denied*, 459 U.S. 838, 103 S.Ct. 85 (1982) (*quoting Heit v. Baird*, 567 F.2d 1157, 1160 (1st Cir. 1977)). *See also Kaufman v. Kansas Gas & Electric Co.*, 634 F.Supp. 1573, 1578 (D. Kan. 1986) (holding plaintiff to strict pleading requirements); *Adkins v. Tony Lama Co., Inc.*, 624 F.Supp. 250, 255 (S.D. Ind. 1985) (conclusory allegations of "futility" insufficient); *Kaufman v. Safeguard Scientifics, Inc.*, 578 F.Supp. 486, 489 (E.D. Pa. 1984) (Rule 23.1 requires "meticulous specification" of the facts surrounding plaintiff's failure to make a demand). As the following discussion illustrates, Kamen's generalized allegations of futility have been consistently rejected by the courts as inadequate under Rule 23.1.

Subsection (b) describes the composition of the Fund's ten-member board of directors. Kamen admits that only three of these directors are "interested" under the Act.[13] The remaining seven members of the board are

---

[13] The ICA provides that "No registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are interested persons of such registered company." 15 U.S.C. § 80a-10(a). Section 2(19) of the Act defines an interested person as follows:

(19) "Interested person" of another person means –

(A) when used with respect to an investment company

(i) any affiliated person of such company,

(ii) any member of the immediate family of any natural person who is an affiliated person of such company,

(Continued on following page)

presumably "non-interested" directors.[14] The mere fact that the directors receive substantial remuneration for

---

(Continued from previous page)

(iii) any interested person of any investment adviser of or principal underwriter for such company.

(iv) any person or partner or employee of any person who at any time since the beginning of the last two fiscal years of such company has acted as legal counsel for such company,

(v) any broker or dealer registered under the Securities Exchange Act of 1934 or any affiliated person of such a broker or dealer. . . .

Provided, That no person shall be deemed to be an interested person of an investment company solely by reason of (aa) his being a member of its board of directors or advisory board or an owner of its securities, or (bb) his membership in the imm [sic]

(v) [sic] any broker or dealer registered under the Securities Exchange Act of 1934 or any affiliated person of such a broker or dealer. . . .

Provided, That no person shall be deemed to be an interested person of an investment company solely by reason of (aa) his being a member of its board of directors or advisory board or an owner of its securities, or (bb) his membership in the immediate family of any person specified in clause (aa) of this proviso;. . . .

15 U.S.C. § 80a-2(19).

[14] Plaintiff also alleges that the president of the Fund is a former president of KFS and a stockholder of KFS's parent, Kemper Corporation. The court questions the relevance of this

(Continued on following page)

acting as directors does not, in and of itself, establish that they could not impartially review the merits of Kamen's excessive fee claim. If the fact that a director is paid for his services was sufficient to avoid Rule 23.1, Rule 23.1 would be rendered ineffective.

Furthermore, the fact that these directors assisted KFS in soliciting the allegedly misleading proxy statement does not obviate Kamen's duty to make a demand. The courts have consistently held that "mere approval of challenged conduct is insufficient to render the demand futile." *Lewis v. Anselmi*, 564 F.Supp. 768, 772 (S.D. N.Y. 1983); *Adkins v. Tony Lama Co., Inc.*, 624 F.Supp. 250, 255 (S.D. Ind. 1985); *Lewis v. Valley*, 476 F.Supp. 62, 64 (S.D. N.Y. 1979). *See generally Lewis v. Graves*, 701 F.2d 245, 248-249 (S.D. N.Y. 1983), and cases cited therein. As the First Circuit aptly remarked, "It does not follow . . . that a director who merely made an erroneous business judgment in connection with what was plainly a corporate act will 'refuse to do [his] duty in behalf on [sic] the corporation if [he] were asked to do so.' Indeed, to excuse demand in these circumstances – majority of the board approval of an allegedly injurious corporate act – would

---

(Continued from previous page)

information on the issue of a demand, since plaintiff does not allege that Hawkinson is even a member of the Fund's Board of Directors. The fact that an *officer* of the Fund had a former affiliation with KFS does not have any bearing on the number of "interested" directors because he would only participate in the Board's decision to pursue the action if he were a *director* of the fund.

lead to serious dilution of Rule 23.1" *In re Kauffman Mutual Funds, Inc.*, 479 F.2d at 265 (citation omitted).[15]

Subsections (d) and (e) state no facts; they merely reiterate Kamen's conclusion of futility based on her conclusory claim that the entire Board is under the control of KFS and Kemper Corporation, its parent. Rule 23.1 requires Kamen to *particularize* her allegations of control. Kamen's complaint implicitly admits that the Board is composed of at least six disinterested directors. She has not presented the court with any information indicating that these directors are incapable of exercising independent judgment or that the three "interested" directors somehow control the outcome of all the Board's decisions. *See Kauffman*, 479 F.2d at 266. A plaintiff's mere speculation that the majority of the board would refuse to take corporate action is insufficient to satisfy Rule 23.1 *Nussbacher*, 518 F.2d at 879 (7th Cir. 1976); *Adkins v. Tony Lama Co., Inc.*, 624 F.Supp. 250, 256 (S.D. Ind. 1985).

In subsection (e) Kamen alleges that demand should be excused because the Fund has moved to dismiss the complaint on substantive grounds.[16] The futility of a demand should be gauged at the time the suit is commenced. *Grossman v. Johnson*, 674 F.2d 115, 123 (1st Cir.), *cert. denied*, 459 U.S. 838, 103 S.Ct. 85 (1982); *Cramer v. GTE Corp.*, 582 F.2d 259, 276 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129, 99 S.Ct. 1048 (1979); *Shlensky v. Dorsey*, 574 F.2d 131, 142 (3d Cir. 1978); *Seidel v. Public Service Co. of New Hampshire*, 616 F.Supp. 1342, 1350 (D. N.H. 1985). "It is clear that 'the filing of the complaint cannot be regarded as a demand to sue, for by starting the action [plaintiff has] . . . usurped the field.' " 7C Wright, Miller & Kane, *Federal Practice & Procedure* § 1831, quoting *Lucking v. Delano*, 117 F.2d 159, 160 (6th Cir. 1941). The fact that a corporation resists the suit or demands that the requirements of Rule 23.1 be met is insufficient to establish that the board would reject a demand if the plaintiff-shareholder had requested it to act. *See Gartenberg v. Merrill Lynch Asset Management, Inc.*, 91 F.R.D. 524, 527 (S.D. N.Y. 1981); *Grossman v. Johnson*, 89 F.R.D. 656, 659 (D. Mass. 1981). Kamen thrust the Fund into an adversary role when she instituted this action. She cannot use the fact that the Fund defended itself in this lawsuit to justify her own failure to comply with Rule 23.1 in the first place.

The demand requirement is a necessary prerequisite to all suits under Rule 23.1.[17] As the court in *Lewis v. Anselmi* noted,

---

[15] The demand would not be excused even if Kamen had named the individual directors in her complaint. The courts have uniformly held that, absent allegations of bias or self-interest, naming the individual directors cannot obviate the demand requirement of Rule 23.1 *See generally Lewis v. Graves*, 701 F.2d 245, 249 (2d Cir. 1983); *Lewis v. Curtis*, 671 F.2d 779, 785 (3d Cir.), *cert. denied*, 459 U.S. 880, 103 S.Ct. 176 (1982); *Lewis v. Sporck*, 612 F.Supp. 1316, 1322 (N.D. Cal. 1985); *Kaufman v. Safeguard Scientifics, Inc.*, 587 F.Supp. 486, 489 (E.D. Pa. 1984).

[16] The Fund has joined Kemper in its motion to dismiss Kamen's § 20(a) claim for failure to make a demand and for failure to state a cause of action.

[17] This court echoes the Seventh Circuit's query in *Nussbacher*: "It may be wondered why counsel would not almost routinely take the course of making a formal demand, diligently and in good faith, and in so doing inform the board adequately of the basis of the claim he was asking them to enforce." 518 F.2d at 877.

> Rule 23.1 represents a strong statement of public policy which this court is bound to enforce. It has its historical origin in a perceived evil, the maintenance of strike suits by minority shareholders which impede corporate management at great cost and to little purpose except the enrichment of counsel, coupled also with unnecessary interference by outsiders with internal corporate affairs, which should have been administered at least in the first instance by those elected by the shareholders to do so.

564 F.Supp. 768, 772 (S.D. N.Y. 1983). The court finds that Kamen's generalized allegations of futility, unsupported by any specific facts, are insufficient to excuse her failure to approach the Fund's Board of Directors before she filed this lawsuit. Accordingly, the court dismisses Kamen's § 20(a) claim for failure to comply with Rule 23.1.

Motion To Strike Jury Demand

The dismissal of Kamen's § 20(a) claim does not affect her § 36(b) claim, which KFS apparently concedes is sufficient for the purposes of Fed.R.Civ.P. 12(b)(6).[18] In addition to the dismissal of the Section 20(a) claim, KFS' motion also seeks to strike Kamen's jury demand on the ground that the Seventh Amendment's right to jury "in actions at law" does not extend to § 36(b) claims, which are essentially equitable in nature.

Section 36(b) of the ICA, 15 U.S.C. § 80a-35(b), creates a cause of action on behalf of a security holder of an

[18] KFS recently filed a motion for summary judgment on the issue of whether Kamen can fairly and adequately represent the other shareholders in this action.

investment company to recover excessive fees paid to the investment company's advisor. Subsection (3) of the Act limits this cause of action by providing:

> No such action shall be brought or maintained against any person other than the recipient of such compensation or payments, and no damages or other relief shall be granted against any person other than the recipient of such compensation or payments. No award of damages shall be recoverable for any period prior to one year before the action was instituted. Any award of damages against such recipient shall be limited to the actual damages resulting from breach of fiduciary duty and *shall in no event exceed the amount of compensation or payments received from such investment company, or the security holders thereof, by such recipient.*

15 U.S.C. § 80a-35(b)(3) (emphasis supplied). The Seventh Circuit has never discussed the right to a jury trial in the context of a Section 36(b) action. To the court's knowledge, only two circuits have addressed the issue, both concluding that a plaintiff in these actions is not entitled to a jury trial on his Section 36(b) claims. *See In re Evangelist*, 760 F.2d 27, 29-30 (1st Cir. 1985); *In re Gartenberg*, 636 F.2d 16, 17-18 (2d Cir. 1980); *cert. denied*, 451 U.S. 910, 101 S.Ct. 1979 (1981). *See also Weissman v. Alliance Capital Management Corp.*, 84 Civ. 8904 slip op. at 5-6 (S.D. N.Y. Nov. 26, 1985), *pet. for mandamus denied sub nom. In re Weissman*, No. 85-3078 (2d Cir. February 5, 1986); *Tarlov v. Paine Webber Cashfund, Inc.*, 559 F.Supp. 429, 441 (D. Conn. 1983); *Jerozal v. Cash Reserve Management, Inc.*, [1982-83 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 99,019 at 94,827 (S.D. N.Y.1982); *Markowitz v. Brady*, 90 F.R.D. 542, 547-48 (S.D. N.Y. 1981).

These courts all reason that, since § 36(b) involves a claim for breach of fiduciary duty and limits damages to restitution of excessive fees, the action is essentially in equity and therefore not covered by the Seventh Amendment. *Evangelist, supra; Gartenberg, supra.* In the present case, Kamen's Section 36(b) claim is identical to those addressed in the cases listed above. She has not presented the court with any authority rejecting the analysis of the First and Second Circuits on this narrow issue.[19] This

---

[19] Kamen argues that § 36(b)'s reference to "damages," and her request for "damages" renders her claim an action at law. This argument has been rejected by every court that has considered it. With respect to the fact that the statute uses the word "damages," the *Gartenberg* court held:

> [I]t seems likely from the context that Congress was using 'damages' merely as a shorthand for 'recovery of money,' not as a legal term of art. Since . . . not all claims for monetary relief are legal in nature, the use of the term 'damages' is not persuasive in this instance. In particular, given the repeated statement in the legislative history that actions under 36(b) are equitable, to be administered on equitable standards, it would seem impossible to conclude from the use of the word 'damages' that Congress thereby provided for a trial by jury.

Gartenberg v. Merrill Lynch Asset Management, Inc., 487 F.Supp. 999, 1006 (S.D. N.Y.), *mand. denied sub nom. In re Gartenberg*, 636 F.2d 16 (2d Cir. 1980), *cert. denied*, 451 U.S. 910, 101 S.Ct. 1979 (1981). *See also In re Evangelist*, 760 F.2d 27, 30 (1st Cir. 1985).

Although the *Evangelist* court was unequivocal in its denial of a right to a jury trial, the *Gartenberg* court qualified its decision in the last paragraph: "Our decision is limited, of course, to the facts of this case. We leave for another day a determination as to the right of a jury trial of a plaintiff making

(Continued on following page)

court agrees with the controlling weight of authority that Section 36(b) creates restitutionary relief for fiduciary breach, which is traditionally addressed by the courts of equity.[20] Accordingly, the court finds that plaintiff has no

---

(Continued from previous page)

a bona fide claim for damages." *In re Gartenberg*, 636 F.2d at 18. Kamen argues that because her complaint seeks damages, she falls within this *Gartenberg* caveat. The Second Circuit has never explained his final comment to its opinion; however, the court finds that Kamen's Section 36(b) claim is no different than that advanced in *Gartenberg*. The fact that her complaint requests "damages" does not automatically render her claim an action at law. As the *Evangelist* court noted,

> [I]n our view, the right to jury trial cannot turn on the simple substitution of a different word. *Dairy Queen, Inc. v. Wood*, 369 U.S. 469, 477-78 (1962) ('the constitutional right to a trial by jury cannot be made to depend on the choice of words used in the pleadings.). . . . Otherwise, any equitable action for money, say for restitution, could become a legal action by the use of the word 'damages' in place of the word 'restitution.'

760 F.2d at 31. The semantics of Kamen's complaint cannot reign over the substance of her Section 36(b) claim, which is an action seeking restitution for excessive fees paid to KFS.

[20] Kamen also argues that Section 44 of the ICA, 15 U.S.C. § 80a-44, refutes KFS' argument regarding the availability of jury trials in § 36(b) suits. Section 44 confers jurisdiction on the federal courts over "all suits in equity and actions at law brought to enforce any liability or duty created by" the ICA, and authorizes the SEC to "intervene as a party in any action or suit to enforce any liability or duty created by, or to enjoin any non-compliance with, Section 36(b) . . . " Kamen maintains that these provisions indicate that actions under § 36(b) can be characterized as suits at law, thereby entitling her to a jury

(Continued on following page)

right to jury trial for his § 36(b) claims, and grants KFS' motion to strike Kamen's jury demand.

Conclusion

In the present case, although Kamen alleged sufficient facts to state a claim under § 20(a), she failed to comply with Rule 23.1's important demand requirement, and her proffered excuse for this non-compliance is insufficient to satisfy the futility exception to the rule. Accordingly, the court dismisses Kamen's § 20(a) claim for failure to make a demand on the Fund's Board of Directors. In addition, the court finds that Kamen is not entitled to a jury trial on her § 36(b) claim, and grants KFS' motion to strike her jury demand.

ENTER:

/s/ JOHN A. NORDBERG
JOHN A. NORDBERG
United States District Judge

Dated: February 2, 1987

(Continued from previous page)

trial. As KFS correctly notes, however, this language merely permits the SEC to intervene in § 36(b) actions; it does not change the equitable nature of the action or the remedy that the plaintiff seeks. The gist of an action under § 36(b) is a suit for an accounting, and the remedy is limited by statute to restitution of the excessive fees paid. Under the circumstances, this action is properly characterized as one in equity, in which Kamen is not entitled to a jury trial.

Minute Order From
(rev 4/illegible)

ORDER DATED MARCH 11, 1987
DENYING RECONSIDERATION

UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

Name of Assigned Judge Nordberg

Sitting Judge if Other Than Assigned Judge

Case Number 85 C 4587 Date March 11, 1987

Case Title Kamen v. Kemper Financial Services

MOTION: (In the following box (a) indicate the party filing the motion, e.g., plaintiff, defendant, 3d-party plaintiff, and (b) state briefly the nature of the motion being presented.)

Plaintiff's motion for reconsideration of this court's February 2, 1987 order

DOCKET ENTRY:
(The balance of this form is reserved for notations by court staff.)

(1) x Judgment is entered as follows:

(2) ___ (Other docket entry:)

The court denies plaintiff's motion for reconsideration.

(3) ___ Filed motion of [use listing in "MOTION" box above].

(4) ___ Brief in support of motion due _____

(5) ___ Answer brief to motion due _______. Reply to answer brief due _____

(6) ___ ___ Hearing
___ Ruling on _____ set for _____ at _____

(7) ___ Status hearing ___ held ___ continued to ___ set for ___ re-set for ___ at _____.

(8) ___ Pretrial conference ___ held ___ continued to ___ set for ___ re-set for _____ at _____.

(9) ___ Trial ___ set for ___ re-set for _____ at _____.

(10) ___ ___ Bench trial ___ Jury trial ___ Hearing held and continued to _____ at _____.

(11) ___ This case is dismissed ___ without ___ with prejudice and without costs ___ by agreement ___ pursuant to ___ FRCP 4(j) (failure to serve) ___ General Rule 21 (want of prosecution) ___ FRCP 41(a)(1) ___ FRCP 41(a)(2)

(12) x [For further detail see xx order on the reverse of ___ order attached to the original minute order form]

___ No notices required.

___ Notices mailed by judge's staff.

___ Notified counsel by telephone.

x Docketing to mail notices.

___ Mail AO 450 form.

EP courtroom deputy's initials

FILED - ED3
1987 MAR 11 P 4:21

Date/time received in central Clerk's Office

4	number of notices	
MAR 12 1987	date docketed	
ETV	docketing dpty. initials	
MAR 12 1987	date mld. notices	Document # 72
ETV	mailing dpty. initials	

(Reserved for use by the Court)

ORDER

On Feburary 2, 1987, this court held that the plaintiff, Jill Kamen, could state an implied right of action under § 20 of the Investment Company Act; that her § 20 claim is a derivative claim which must be dismissed for failure to comply with the demand requirement of Rule 23.1; and that she is not entitled to a jury trial on her claims arising under § 36(b) of the Act. In the present motion, Kamen requests the court to reconsider its conclusion with respect to the demand requirement and the right to a jury trial under Section 36(b) of the ICA. For the reasons set forth below, the court adheres to its February 2, 1987 rulings on both these issues, and denies Kamen's motion for reconsideration.

In support of her motion for reconsideration with respect to Rule 23.1's demand requirement, Kamen has filed excerpts from the depositions of six of the independent directors in which these directors expressed their present opinions of the merits of Kamen's suit. According

to Kamen, these excerpts establish that the directors would not have prosecuted this action, and that a demand would have been futile. The court rejects this argument for two reasons. First, the futility of the demand is not gauged by the fact that they would not file the suit, it is gauged by a determination of whether the directors are sufficiently detached and independent that they could exercise sound business judgment in responding to the plaintiff's complaint. Although the deposition transcripts indicate that the directors presently do not agree with Kamen, they do not indicate that the directors would not have thoroughly investigated the complaint to determine whether the corporation should institute action against KFS or attempt to restructure its fee arrangement with KFS. None of the directors testified that they would have ignored Kamen's request if she had presented it to them before filing suit.

Second, as this court held in its February 2, 1987 memorandum opinion and order,

> The futility of a demand should be gauged at the time the suit is commenced. *Grossman v. Johnson*, 674 F.2d 115, 123 (1st Cir.), *cert. denied*, 459 U.S. 838, 103 S.Ct. 85 (1982); *Cramer v. GTE Corp.*, 582 F.2d 259, 276 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129, 99 S.Ct. 1048 (1979). . . . The fact that a corporation resists the suit or demands that the requirements of Rule 23.1 be met is insufficient to establish that the board would reject a demand if the shareholder had requested it to act.

Memorandum Opinion at 19. (other citations omitted). The futility of the demand should be demonstrated at the time the case was filed because that is the time that the

shareholder decided to bypass the board of directors and file suit on her own. Once a plaintiff has taken the decision away from the directors, one would expect the directors to formulate some views on the propriety of the litigation. However, the mere fact that the directors indicate their disagreement with the lawsuit after it is filed does not indicate that they would not have considered a timely demand. Therefore, the court denies plaintiff's motion for reconsideration with respect to the dismissal for failure to comply with rule 23.1's demand requirement.

Plaintiff's argument with respect to the jury demand presents the same argument considered and rejected in this court's February 2, 1987 opinion. *See* pp. 20-23. The court denies the motion to reconsider this ruling.

Order

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

March 30, 1987

By the Court:

JILL S. KAMEN,

Petitioner,

No. 87-1455

v.

HONORABLE JOHN A. NORDBERG, United States District Judge of the District Court for the Northern District of Illinois, Eastern Division,

Respondent.

Petition for Writ of Mandamus

This matter comes before the court for its consideration of the "PETITION FOR WRIT OF MANDAMUS" filed herein on March 24, 1987 by counsel for the petitioner.

On consideration thereof,

IT IS ORDERED that counsel for Kemper Financial Services, as a respondent to the petition under Rule 21(b), Fed. R. App. P., shall file a response to this petition by April 9, 1987. By that same date, petitioner shall file a supplemental memorandum addressing the applicability to this case of our decision in *First National Bank of Waukesha v. Warren*, 796 F.2d 999 (7th Cir. 1986).

Order Denying Petition for Writ of Mandamus

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

April 13, 1987

Before

HON. JOEL M. FLAUM, *Circuit Judge*
HON. FRANK H. EASTERBROOK, *Circuit Judge*
HON. DANIEL A. MANION, *Circuit Judge*

JILL S. KAMEN,

Petitioner,

No. 87-1455

v.

HONORABLE JOHN A. NORDBERG, United States District Judge of the District Court for the Northern District of Illinois, Eastern Division,

Respondent.

Petition for Writ of Mandamus

This matter comes before the court for its consideration upon the following documents:

1. The "PETITION FOR WRIT OF MANDAMUS" filed herein on March 24, 1987.

2. The "PETITIONER'S SUPPLEMENTAL MEMORANDUM" filed herein on April 9, 1987.

3. The "KEMPER FINANCIAL SERVICES, INC.'S ANSWER TO THE PETITION FOR WRIT OF MANDAMUS" filed herein on April 9, 1987.

On consideration thereof,

IT IS ORDERED that the "PETITION FOR WRIT OF MANDAMUS" is DENIED. *First National Bank of Waukesha v. Warren*, 796 F.2d 999 (7th Cir. 1986).

Order

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

April 28, 1987

By the Court:

JILL S. KAMEN,

Petitioner,

No. 87-1455

v.

HONORABLE JOHN A. NORDBERG, United States District Judge of the District Court for the Northern District of Illinois, Eastern Division,

Respondent.

Petition for Writ of Mandamus

Judge Flaum has recused himself from participation in this appeal and withdraws his vote on the court's order of April 13, 1987. That order will stand on the votes of Judge Easterbrook and Judge Manion. The petitioner's request for rehearing *en banc* is still pending.

Order Denying Rehearing

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

May 19, 1987

Before
HON. FRANK H. EASTERBROOK, *Circuit Judge*
HON. DANIEL A. MANION, *Circuit Judge*

No. 87-1455

In the Matter of:

JILL S. KAMEN,

Petitioner.

Petition for Writ of Mandamus

ORDER

Petitioner filed a petition for rehearing and suggestion of rehearing en banc on April 24, 1987. At the request of a member of the panel, the petition was circulated to the full court. See OPERATING PROCEDURE 1(a)(2). No judge in regular active service has requested a vote on the suggestion of rehearing en banc, and both of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED. Circuit Judge Flaum did not participate in the consideration of or decision on this petition.

DECISION OF THE U.S. SUPREME COURT OF MARCH 7, 1988
DENYING PETITION FOR WRIT OF CERTIORARI

SUPREME COURT OF THE UNITED STATES

Jill S. KAMEN v. John A. NORDBERG, Judge United States District Court for the Northern District of Illinois (Kemper Financial Services, Inc., et al., Real Parties in Interest). No. 86-2070.

On petition for writ of certiorari to the United States Court of Appeals for the Seventh Circuit.

March 7, 1988. The petition for a writ of certiorari is denied.

Justice WHITE, dissenting.

The issue here is when mandamus relief will be available to a party who claims that the District Court wrongly deprived him of the right to a jury trial. Petitioner is a shareholder in a mutual fund and brought a derivative suit against the two companies that administer the fund, alleging breach of fiduciary duty under § 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 50a-35(b). The District Court granted defendants' motion to strike petitioner's demand for a jury trial on this claim and petitioner sought mandamus from the Court of Appeals to compel the District Court to honor his demand for a jury trial. The Seventh Circuit denied relief in an order, *Kamen v. Kemper Financial Services, Inc.*, Civ. Action No. 87-1455 (CA7, Apr. 13, 1987), citing its prior decision in *First Nat'l Bank v. Warren*, 796 F.2d 999 (CA7 1986).

In *Warren*, the Seventh Circuit held that mandamus will lie to enforce a party's demand for a jury trial only when, first, the party's right to a jury trial is clear and

indisputable and, second, the party has no other adequate means to attain the relief he desires. 796 F.2d at 1006. The second point is especially critical because it will prevent interlocutory review of many requests for a writ of mandamus to direct the granting of a jury trial, as in many cases the petitioning party can seek this same relief on appeal from the ultimate resolution of the case in the trial court. This decision conflicts with the decisions of other Courts of Appeals, which hold that mandamus relief is available to review an order denying a claimed right of trial by jury, and that a proper petition for mandamus in these circumstances obliges the Court of Appeals to address the merits of the claimed right to a jury trial. *In re Union Nacional de Trabajadores*, 502 F.2d 113, 115-116 (CA1 1974), vacated on other grounds, 527 F.2d 602 (1975); *Lee Pharmaceuticals v. Mishler*, 526 F.2d 1115, 1116-1117 (CA2 1975) (*per curiam*); *Eldredge v. Gourley*, 505 F.2d 769, 770 (CA3 1974); *General Tire & Rubber Co. v. Watkins*, 331 F.2d 192, 194 (CA4), cert. denied, 377 U.S. 952, 84 S.Ct. 1629, 12 L.Ed.2d 498 (1964); *Black v. Boyd*, 248 F.2d 156, 159-161 (CA6 1957); *In re Vorpahl*, 695 F.2d 318, 319 (CA8 1982); *Owens-Illinois, Inc. v. U.S. District Ct.*, 698 F.2d 967, 969 (CA9 1983); *In re Zweibon*, 565 F.2d 742, 745-746 (CADC 1977) (*per curiam*). It may also be inconsistent with this Court's prior decisions in *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 79 S.Ct. 948, 3 L.Ed.2d 988 (1959), and *Dairy Queen, Inc. v. Wood*, 369 U.S. 469, 82 S.Ct. 894, 8 L.Ed.2d 44 (1962), which emphasize the responsibility of the Courts of Appeals to grant mandamus relief where it is necessary to protect the constitutional right to trial by jury. I would grant certiorari to resolve the split among the Circuits on this issue.

REPORT AND RECOMMENDATION OF
MAGISTRATE BALOG
DATED APRIL 21, 1989

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

JILL S. KAMEN, Plaintiff, v. KEMPER FINANCIAL SERVICES, INC., and CASH EQUIVALENT FUND, INC., Defendant.	85 C 4587

TO: HONORABLE JOHN A. NORDBERG, JUDGE
UNITED STATES DISTRICT COURT

HONORABLE SIR:

REPORT AND RECOMMENDATION
of Magistrate James T. Balog

Before the court is the motion of defendant Kemper Financial Services, Inc., ("Kemper") for summary judgment on the issue of the adequacy of plaintiff Jill S. Kamen as a representative of the class of shareholders in Cash Equivalent Fund, Inc.

The plaintiff brings this action as a representative of all shareholders in Cash Equivalent Fund, Inc. ("Fund"), a money market mutual fund managed and administered by Kemper. Plaintiff claims that the fees charged by Kemper for management and administration are excessive,

and constitute a breach of its fiduciary duty under §36(b) of the Investment Company Act ("Act"). 15 U.S.C. §80a-35(b). Basically, plaintiff contends that the Fund involves a limited number and variety of investments, and should not require extensive management. She further contends that increased compensation to Kemper has resulted from an enormous increase in the Fund's assets. Plaintiff claims that the fee structure is simply disproportionate to the services Kemper renders.

Kemper's motion for summary judgment does not attack plaintiff's allegations, but is limited to the contention that she is not a proper representative of the shareholder, and therefore is without standing to bring this action. Kemper basically argues that plaintiff is an atypical shareholder in that she has not taken advantage of the services provided by the Fund or Kemper. (Memorandum in Support of Kemper's Motion to Dismiss, at 4). In addition, Kemper states that the other shareholders have approved the fees charged by Kemper, and that after receiving notice of this action, they approved a fee increase. Finally, Kemper claims that plaintiff has shown no real interest or comprehension of the issues in the lawsuit. As such, Kemper contends that plaintiff cannot fairly and adequately represent the shareholders' interests in this suit.

The parties to this action alternatively refer to plaintiff's suit as a class action and a shareholders' derivative suit. Because this case was brought under §36(b) of the Act, it is not technically a derivative suit. A derivative suit allows a shareholder to claim a right that could have been, but was not, asserted by the corporation in court. Fed.R.Civ.P. 23.1; *Daily Income Fund, Inc. v. Fox*, 484 U.S.

523, 528. 104 S.Ct. 831, 834 (1984). Section 36(b) creates a right which can be enforced only by a shareholder or the Securities Exchange Commission. *Id.* at 535, 104 S.Ct. at 838. Even though such a right may be asserted on behalf of the corporation, it is not one that the corporation may assert in court. *Id.*, Consequently, the rules governing derivative suits are not applicable to §36(b) actions. The "fair and adequate" representation requirement of Rule 23.1 does not apply to plaintiff's action.

While Rule 23.1 may not be applicable, plaintiff still seeks to maintain this suit as a class action, and is therefore subject to the rules applicable to such actions. Under Rule 23, a class action may be maintained only if:

> (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and aequately [sic] protect the interests of the class.

Kemper's motion for summary judgment raises only the fourth requirement as an issue: whether plaintiff will fairly and adequately protect the interests of the class.

Adequacy of representation ensures that all class members receive the protection of their rights that due process requires. *Hansberry v. Lee*, 311 U.S. 32, 45, 61 S.Ct. 115, 119 (1940). The requirement encompasses two notions: that named plaintiff's counsel has the expertise necessary to represent the class; and that named plaintiff will pursue the claims aggressively, with no conflict between its interests and those of the class. *Secretary of Labor v. Fitzsimmons*, 805 F.2d 682, 697 (7th Cir. 1986);

Armstrong v. Chicago Park Dist., 117 F.R.D. 623, 631 (N.D. Ill. 1987).

With regard to the expertise of plaintiff's counsel, Kemper's arguments must fail. Kemper does not dispute the fact that Richard M. Meyer, plaintiff's lead counsel, has a great deal of experience in cases of this nature. Indeed, Mr. Meyer successfully argued the *Fox* case before the United States Supreme Court. 484 U.S. at 524, 104 S.Ct. at 832. Kemper is apparently far more concerned with plaintiff's own lack of knowledge in this case. Plaintiff's lack of knowledge of the case, or even her minimal involvement in the fleshing out of her claim, is not enough to warrant summary judgment in Kemper's favor. *Goldwater v. Alston & Bird*, 116 F.R.D. 342, 353 (S.D. Ill. 1987), *citing Grossman v. Waste Management, Inc.*, 100 F.R.D. 781, 792 (N.D. Ill. 1984). Thus, neither the experience of plaintiff's counsel nor the minimal knowledge of plaintiff are sufficient to prevent plaintiff's maintenance of her claim as a class action.

Thus, the other factor in judging the adequacy of plaintiff as representative of the class is whether plaintiff's interests are sufficiently commensurate with those of the other shareholders. This determination is a question of fact depending on the circumstances of each case. *Schy v. Susquehanna Corp.*, 419 F.2d 1112, 1116 (7th Cir.) *cert. denied* 400 U.S. 826 (1970). In this case, Kemper cites several material facts which have gone undisputed by plaintiff: no other shareholder has joined in this suit, instituted a claim, or inquired into plaintiff's action; the other shareholders have approved the fees charged by Kemper; after notice of plaintiff's allegations, the shareholders approved an increase in fees. Based on these

facts, it can only be said that plaintiff's interests are antagonistic to those of the other shareholders. In such a case, plaintiff cannot adequately protect those interests. *Gomez v. Illinois State Bd. of Educ.*, 117 F.R.D. 394, 402 (N.D. Ill. 1987). Plaintiff argues that the measure of adequacy of representation should not be based on the number of shareholders plaintiff represents, but on how well plaintiff can advance the interests of similarly situated shareholders. (Plaintiff's Memorandum in Opposition, at 11-12). Yet, Plaintiff points to no other similarly situated shareholders, even in the face of Kemper's contention that she stands alone. It is apparent from the record as it stands that plaintiff's concerns are not those of a class, but are a private matter. As such, plaintiff cannot maintain this suit as a class action.

For these reasons, it is recommended that defendant's motion for summary judgment on the issue of plaintiff's adequacy as class representative be granted.

Respectfully submitted,

/s/ James T. Balog
JAMES T. BALOG
United States Magistrate

DATE: APRIL 21, 1989

Any objections to this Report and Recommendation must be filed with the Clerk of court within ten (10) days of receipt of this notice. Failure to file objections within the specified time waives the right to appeal the District Court's order. Thomas v. Arn, 108 S.Ct. 466 (1985).

Copies to:

Joel J. Sprayregen
Clifford E. Yuknis
Richard M. Meyer
SHEFSKY, SAITLIN
& PROELICH
444 North Michigan Ave.,
Suite 2300
Chicago, IL 60611

Arthur J. McGivern
Gwenda M. Burkhardt
Charles F. Custer
VEDDER, PRICE,
KAUFMAN &
KAMMHOLZ
222 North LaSalle Street
Chicago, Illinois 60611

MINUTE ORDER DATED AUGUST 3, 1989
ADOPTING MAGISTRATE'S REPORT
AND RECOMMENDATION

Minute Order Form
(rev. 3/illegible)
UNITED STATES DISTRICT COURT, NORTHERN
DISTRICT OF ILLINOIS, EASTERN DIVISION

Name of Assigned Judge or Magistrate NORDBERG

Signing Judge or Mag. If Other
Than Assigned Judge/Mag. ASPEN

Case Number 85 C 4587 Date August 3, 1989

Case Title Jill Kamen v. Kemper Financial Services, Inc., et al

MOTION: [In the following box (a) indicate the party filing the motion, e.g., plaintiff, defendant, 3d-party plaintiff, and (b) state briefly the nature of the motion being presented]

DOCKET ENTRY:

(The balance of this form is reserved for notations by court staff.)

(1) ___ Judgment is entered as follows:

(2) A (Other docket entry)

The Court overrules plaintiff's objections to the Magistrate's report and recommendation of April 21, 1989. The Court adopts the Magistrate's Report and Recommendation. Accordingly, based upon the reasons set forth in the Report and Recommendation and in defendant's brief in support of its motion for summary judgment, the Court grants defendant's motion for summary judgment on the issue of plaintiff's adequacy as a class representative. This cause may proceed, if plaintiff so chooses, as a non-class action. A status hearing is set for August 15, 1989, at 2:00 p.m., before Judge Aspen. It is so ordered.

(3) ___ Filed motion of [use listing in "MOTION" box above].

Marvin E. Aspen

(4) ___ Brief in support of motion due _____

(5) ___ Answer brief to motion due _______. Reply to answer brief due _____

(6) ___ ___ Hearing
___ Ruling on _____ set for _____ at _____

(7) ___ Status hearing ___ held ___ continued to ___ set for ___ re-set for ___ at _____.

(8) ___ Pretrial conference ___ held ___ continued to ___ set for ___ re-set for _____ at _____.

(9) ___ Trial ___ set for ___ re-set for _____ at _____.

(10) ___ ___ Bench trial ___ Jury trial ___ Hearing held and continued to _____ at _____.

(11) ___ This case is dismissed ___ without ___ with prejudice and without costs ___ by agreement ___ pursuant to ___ FRCP 4(j) (failure to serve) ___ General Rule 21 (want of prosecution) ___ FRCP 41(a)(1) ___ FRCP 41(a)(2)

(12) ___ [For further detail see ___ order on the reverse of ___ order attached to the original minute order form]

___ No notices required.

___ Notices mailed by judge's staff.

___ Notified counsel by telephone.

✔ Docketing to mail notices.

___ Mail AO 450 form.

___ Copy to judge/magistrate

courtroom deputy's initials Gl

ED-1
RECEIVED FOR DOCKETING
89 AUG - 3 PM 3:53

Date/time received in central Clerk's Office

3	number of notices	
AUG 4 1989	date docketed	
Illegible initials	docketing dpty. initials	Document # 96
AUG 4 1989	date mid. notices	
Illegible initials	mailing dpty. initials	

MINUTE ORDER DATED SEPTEMBER 1, 1989
AMENDING AUGUST 3, 1989 ORDER

Minute Order Form
(rev. 3/illegible)

UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

Name of Assigned Judge or Magistrate NORDBERG

Signing Judge/Mag. If Other Than Assigned Judge/Mag. ASPEN

Case Number 85 C 4587 Date September 1, 1989

Case Title Jill Kamen v. Kemper Financial Services, Inc., et al

MOTION: [In the following box (a) indicate the party filing the motion, e.g., plaintiff, defendant, 3d-party plaintiff, and (b) state briefly the nature of the motion being presented]

Sent for Microfilming SEP 07 1989 Expired on Sep 8 1989

DOCKET ENTRY:
(The balance of this form is reserved for notations by court staff.)

(1) X Judgment is entered as follows:

(2) ___ (Other docket entry)

Since in our August 3, 1989 order, plaintiff was adjudicated as a non-adequate representative plaintiff cannot proceed individually in this § 36(B) action. For that reason, our August 3, 1989 order is amended by deleting the following sentence: "This cause may proceed, if plaintiff so chooses, as a non-class action. "Accordingly, judgment is entered in favor of defendants. It is so ordered.

(3) ___ Filed motion of [use listing in "MOTION" box above].

(4) ___ Brief in support of motion due _____

(5) ___ Answer brief to motion due _______. Reply to answer brief due _____

(6) ___ ___ Hearing
___ Ruling on _____ set for _____ at _____

(7) ✓ Status hearing ✓ held ___ continued to ___ set for ___ re-set for ___ at _____.

(8) ___ Pretrial conference ___ held ___ continued to ___ set for ___ re-set for _____ at _____.

(9) ___ Trial ___ set for ___ re-set for _____ at _____.

(10) ___ ___ Bench trial ___ Jury trial ___ Hearing held and continued to _____ at _____.

(11) ___ This case is dismissed ___ without ___ with prejudice and without costs ___ by agreement ___ pursuant to ___ FRCP 4(j) (failure to serve) ___ General Rule 21 (want of prosecution) ___ FRCP 41(a)(1) ___ FRCP 41(a)(2)

(12) ___ (For further detail see ___ order on the reverse of ___ order attached to the original minute order form)

___ No notices required.

✓ Notices mailed by judge's staff.

___ Notified counsel by telephone.

___ Docketing to mail notices.

___ Mail AO 450 form.

___ Copy to judge/magistrate

courtroom deputy's initials Gl

ED-1
RECEIVED FOR DOCKETING
89 SEP – 7 AM 8:24

Date/time received in central Clerk's Office

4	number of notices	
	date docketed	
MP	docketing dpty. initials	Document # 98
9-6-89	date mid. notices	
GL	mailing dpty. initials	

JUDGMENT DATED SEPTEMBER 1, 1989

AC 450 (Rev. 5, 85) Judgment in a Civil Case

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
Eastern Division

Jill Kamen JUDGMENT IN A CIVIL CASE

V.

Kemper Financial Services, Inc.
Cash Equivalent Fund, Inc.

CASE NUMBER: 85 C 4587

___ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

XX Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED

that since in our August 3, 1989 order, plaintiff was adjudicated as a non-adequate representative plaintiff cannot proceed individually in this § 36(B) action. For this reason, our August 3, 1989 order is amended by deleting the following sentence: "This cause may proceed, if plaintiff so chooses, as a non-class action." Accordingly, judgment is entered in favor of defendants.

9-1-89 H. STUART CUNNINGHAM
Date *Clerk*

Illegible
(By) Deputy Clerk

Supplemental Amended Complaint

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

85 C 4587 – Judge Nordberg

JILL S. KAMEN,

Plaintiff,

-against-

KEMPER FINANCIAL SERVICES, INC., and
CASH EQUIVALENT FUND, INC.,

Defendants.

PLAINTIFF DEMANDS TRIAL BY JURY

Plaintiff, by her attorneys, alleges as follows, on information and belief, except as to the allegations in paragraph 3, which are alleged on knowledge:

1. This Court has jurisdiction of this action under the Investment Company Act of 1940, as amended, 15 U.S.C. § 80a-1 et seq. (the "Act"), and in particular § 36 and § 44 thereof, 15 U.S.C. § 80a-35 and § 80a-43.

2. The cause of action arises under the Act and in particular under § 20 and § 36 thereof.

3. Plaintiff is a shareholder of defendant Cash Equivalent Fund, Inc. (the "Fund") and has been a

shareholder of the Fund at all times relevant herein. Plaintiff brings this action on behalf of the Fund.

4. The Fund is a diversified open-end investment company registered with the Securities and Exchange Commission under the Act. Its principal place of business is located at 120 South LaSalle Street, Chicago, Illinois 60603. It is the type of investment company commonly referred to as a money market fund.

5. (a). The Fund's investment objective is to seek the maximum current income consistent with stability of capital. The Fund invests in a range of short-term money market instruments which have muturities [sic] not exceeding one year. These instruments include obligations of the United States Government and its agencies and instrumentalities, certificates of deposit, bankers acceptances, fixed time deposits, commercial paper, and repurchase agreements. Although the Fund did not commence operations until March 16, 1979, its total assets as of April 23, 1985 were approximately $4,683,000,000 in its money market portfolio and $470,000,000 in its government securities portfolio.

(b) As of November 26, 1986 the Fund's total assets consisted of $5,390,000,000 in its money market portfolio and $660,000,000 in its government securities portfolio.

6. At all times relevant herein, defendant Kemper Financial Services, Inc. ("KFS") has acted as investment adviser, manager, primary administrator and underwriter for the Fund.

7 (a). During all times relevant herein, KFS has received and continues to receive a monthly fee divided

into two parts and paid under two separate agreements. Under an investment management agreement, the Fund pays KFS an investment management fee at the annual rate of .22 of 1% of the first $500,000,000 of the combined average daily net assets of the portfolios KFS managers, .20 of of [sic] 1% of the next $500,000,000, .175 of 1% of the next $1 billion, .16% of the next $1 billion and .15 of 1% of average daily net assets of such portfolios over $3 billion. Under an administration, shareholder services and distribution agreement ("administration agreement") the Fund pays KFS an annual fee, payable monthly, on a basis of .33% of the first $500,000,000 of average daily net assets, .30% of the next $500,000,00, [sic] .275% of the next $1 billion, .265% of the next $1 billion, and .25% of average daily net assets over $3 billion.

(b). Effective November 4, 1986, KFS caused the administration agreement with the Fund to be amended to substantially increase the fees payable by the Fund to KFS. Under the amended agreement, the Fund pays to KFS administration fees at the annual rate at .38%. This increase required a change in the expense limitation which otherwise would have been exceeded by the enormous fee burden imposed upon the Fund.

(c). The administration agreement and its amendment were purportedly adopted pursuant to Rule 12b-1 promulgated by the Securities and Exchange Commission under the Act. Under that Rule payments may be made by an investment company, such as the Fund, only if they are pursuant to a plan primarily intended to result in the sale of shares of such investment company. However, the administration agreement entered into between the Fund

and KFS and the amendment thereto encompass payments which are not primarily intended to result in the sale of Fund shares. Indeed, the payments made pursuant to the administration agreement are not based upon sales of Fund shares, but rather upon the assets previously invested in the Fund by customers of KFS affiliates and other broker-dealers to whom the payments are made. Those payments are made without regard to whether sales are being effected by such entities. They are made primarily to enrich KFS, the KFS affiliates and the broker-dealers and are designed neither to promote the sale of Fund shares nor to benefit the Fund or its shareholders.

8. Because of the tremendous growth in the size of the Fund, the fees paid and payable to KFS have increased enormously. Thus, for the fiscal year ended July 31, 1984, the Fund paid KFS nearly $20,000,000 in fees. Of this amount, $7,481,000 was paid under the investment management agreement and $11,936,000 was paid under the administration agreement. KFS has entered into related services agreements with various firms and, during the 1984 fiscal year paid $11,602,000 to such firms. Of that amount, $2,817,000 was paid to broker-dealer firms affiliated with Kemper Corporation, of which KFS is a wholly owned subsidiary. At the present time, the Fund's obligations to KFS under the agreements have increased with the size of the Fund and are running at a rate in excess of $33,000,000 per year. Under the amended administration agreement, firms affiliated with KFS will receive approximately $5,750,000 per year at the present size of the Fund.

9. Unlike most other investment companies, the management of the assets of the money market fund, such as the Fund herein, does not require the detailed analysis of industries nor of complex industrial companies and the concomitant retention of a large staff of highly paid and sophisticated securities analysts. Indeed, the assets of the fund, are and have been, invested in a relatively concentrated manner in fixed income obligations maturing in one year or less. In the ordinary course of operations, decisions to purchase are made on the same day that the funds are received.

10. Despite the huge growth in the size of the Fund, the only changes in the fee structure were made on December 1, 1981 and November 4, 1986 when, in spite of the economics of scale resulting from the Fund's enormous growth, the fees were increased by virtue of the adoption and amendment of the administration agreement.

11. As a result of the tremendous increase in the assets of the Fund, the compensation paid and payable to KFS has increased enormously and disproportionately to the services rendered by it.

12. In addition to acting as investment manager to the Fund, KFS also acts as an investment manager to numerous other accounts and investment companies. Among those investment companies is Kemper Money Market Fund, Inc. ("MM"). MM, like the Fund, is a money market fund with the identical objective of obtaining maximum current income to the extent consistent with stability of principal. It is approximately the same size as the Fund, has approximately the same number of shareholders, and invests in the same types of securities as does the Fund. The directors and many of the officers

and other personnel servicing MM are the same as those performing services for the Fund. KFS is the investment adviser, manager, and underwriter for MM and supplies to MM substantially the same services that it supplies or causes to be supplied to the Fund. Yet, KFS exacts substantially greater fees from the Fund than it does from MM and many of its other clients. Thus, in the year ended July 31, 1984, the Fund's expenses were .72% of its average net assets, whereas those of MM were only .53%, and in every year since 1981 the expenses of the Fund have been significantly greater than those of MM. As a result, the Fund's yield for the year ended September 30, 1984 was approximately 21 basis points less than that of MM, so that the Fund's investment objective of obtaining maximum current income consistent with stability was effectively thwarted by KFS's exaction of exorbitant fees.

13. On or about September 12, 1984, KFS caused to be distributed to the shareholders of the Fund a proxy statement for the annual meeting of shareholders on November 8, 1984. One of the principal purposes of the meeting which KFS was eager to accomplish was to obtain shareholder approval of the continuance of the investment management agreement between the Fund and KFS. The shareholders were asked to approve the agreement and were offered no alternative in the event of disapproval. As part of this solicitation, the proxy statement compared the services and fees offered and received by KFS from other investment companies. The proxy statement correctly described the services rendered to MM as being similar to those rendered to the Fund, but it misleadingly described the fees charged to MM as consisting of "a maximum fee of .50 of 1% of the first

$215,000,000 with lesser rates on additional assets." This gave the false impression that the fees paid by MM were as high or higher than the fees paid by the Fund, whereas KFS knew that the fees received by it from MM were substantially lower than those received by it from the Fund, and that, in fact, for the year ended July 31, 1984 the fees received by KFS from MM aggregated only .28% of MM's average daily net assets. In disseminating the proxy statement to the shareholders of the Fund, KFS used the mails and means and instrumentalities of interstate commerce in violation of § 20 of the Act. The solicitation was successful, and KFS obtained shareholder approval of its management agreement with the Fund, to the damage of the Fund and its shareholders.

14. Because of the limited number, nature and variety of the Fund's investments, the investment decisions of the Fund can be made by a single person, or, at most, a handful of persons. The research and advisory activities of KFS are merely routine and administrative in nature, do not require any significant expertise or investment acumen, are performed (and were performed prior to the formation of the Fund) by KFS for other of its accounts, and consist principally of purchasing and "turning over" money market instruments with a limited number of institutions. The incremental costs to KFS of performing these services for the Fund is minimal. In short, the investment advice provided by KFS is not worth the fees paid for that advice by the Fund and has not been worth the fees paid during the period covered by this complaint. Other advisers performed and have performed similar or superior services for lesser rates.

15. The advisory and management fees paid by the Fund to KFS are exorbitant, unreasonable, excessive and completely disproportionate to the services rendered in return therefore.

16. Pursuant to § 36(b) of the Act, KFS has a fiduciary duty with respect to the receipt of compensation from the Fund. By virtue of the foregoing, KFS has breached its fiduciary duty to the Fund.

17. No demand has been made by the plaintiff upon the Fund or its directors to institute or prosecute this action for the following reasons:

(a) With respect to the claims asserted under § 36(b) of the Act, no such demand is required;

(b) The board of directors of the Fund consists of ten members. Of those, three are "interested" as defined by the Act; that is, they have a personal financial interest in KFS. In addition, the president of the Fund, John Hawkinson, was formerly president of KFS and is a stockholder of Kemper Corporation, KFS's parent. Furthermore, the so-called "non-interested" directors currently receive aggregate remuneration of approximately $300,000 a year for serving as directors of the Fund and of all of the other funds in the Kemper group. They are dependent upon and subservient to KFS and Kemper Corporation, its parent;

(c) The proxy statement referred to in paragraph 13 above stated: "The accompanying proxy is solicited by the Board of Directors of the Fund . . . ", and indeed, the directors did vote, without dissent, to distribute the proxy statement to Fund shareholders. Any suit, such as

the instant suit, brought to establish liability for the material false statements contained in that proxy statement would, if successful, tend to establish culpability and liability on the part of all of the directors of the Fund;

(d) Requiring the plaintiff to make a demand on the Fund or its directors to institute or prosecute this action would be futile. It would be tantamount to asking the directors to sue themselves. Moreover, were the directors to accept such an invitation and institute an action, the prosecution of the action would be in hostile hands inimical to its success;

(e) All of the directors, and the Fund itself, as well as its personnel and policies, are under the control of KFS and Kemper Corporation, its parent;

(f) In responding to the original complaint, the Fund, both in its answer and motion to dismiss, has sought the dismissal of the complaint on substantive grounds;

(g) Under all of the circumstances present in this case, application of a demand requirement would be inconsistent with the federal policy underlying § 20 of the Investment Company Act.

WHEREFORE, plaintiff prays for judgment:

(1) requiring KFS to pay to the Fund its damages;

(2) awarding plaintiff the costs and expenses of this action, including reasonable attorneys' fees; and

(3) awarding plaintiff such other and further relief as the Court may deem just and proper.

Dated: Chicago, Illinois
December ___, 1986

JOEL J. SPRAYREGEN
CLIFFORD E. YUKNIS
SHEFSKY, SAITLIN & FROELICH, LTD.
By: /s/ CLIFFORD E. YUKNIS
444 North Michigan Avenue
Suite 2300
Chicago, Illinois 60611
(312) 527-4000

RICHARD M. MEYER
MILBERG WEISS BERSHAD SPECTHRIE & LERACH
By: /s/ RICHARD M. MEYER
One Penn Plaza
New York, New York 10119
(212) 594-5300

Attorneys for Plaintiff

PLAINTIFF'S VERIFICATION

STATE OF NEW YORK,
COUNTY OF NASSAU, ss.:

JILL S. KAMEN, being duly sworn, deposes and says that I am the plaintiff named herein, and that I have read the foregoing Amended Complaint and know the contents thereof, and that the same is true to my own knowledge except as to those matters therein stated to be alleged upon information and belief and as to those matters I believe them to be true.

____
JILL S. KAMEN

Sworn to before me this ___ day of
December, 1986

____
NOTARY PUBLIC

Statutes and Rule Involved

Section 20(a) of the Investment Company Act of 1940, as amended; 15 U.S.C. § 80a-20(a):

(a) It shall be unlawful for any person, by use of the mails or any means or instrumentality of interstate commerce or otherwise, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security of which a registered investment company is the issuer in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 36(b) of the Investment Company Act of 1940, as amended; 15 U.S.C. § 80a-35(b):

(b) For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. With respect to any such action the following provisions shall apply:

(1) It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty.

(2) In any such action approval by the board of directors of such investment company of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, and ratification or approval of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances.

(3) No such action shall be brought or maintained against any person other than the recipient of such compensation or payments, and no damages or other relief shall be granted against any person other than the recipient of such compensation or payments. No award of damages shall be recoverable for any period prior to one year before the action was instituted. Any award of damages against such recipient shall be limited to the actual damages resulting from the breach of fiduciary duty and shall in no event exceed the amount of compensation or payments received from such investment company, or the security holders thereof, by such recipient.

(4) This subsection shall not apply to compensation or payments made in connection with transactions subject to section 80a-17 of this title, or rules, regulations, or orders thereunder, or to sales loans for the acquisition of any security issued by a registered investment company.

(5) Any action pursuant to this subsection may be brought only in an appropriate district court of the United States.

(6) No finding by a court with respect to a breach of fiduciary duty under this subsection shall be made a basis (A) for a finding of a violation of this subchapter for the purposes of sections 80a-9 and 80a-48 of this title, section 78o of this title, or section 80b-3 of this title, or (B) for an injunction to prohibit any person from serving in any of the capacities enumerated in subsection (a) of this section.

Section 44 of the Investment Company Act of 1940, as amended; 15 U.S.C. § 80a-43:

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit, or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be

served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28, United States Code. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court. The Commission may intervene as a party in any action or suit to enforce any liability or duty created by, or to enjoin any noncompliance with, section 36(b) of this title at any stage of such action or suit prior to final judgment therein.

Rule 23.1

Federal Rules of Civil Procedure:

Derivative Actions by Shareholders

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for

the plaintiff's failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.